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Supreme Court of the United States

October Term, 1942
No. 7

IN THE MATTER
of
THE WESTERN PACIFIC RAILROAD COMPANY,
a corporation,
Debtor,

FREDERICK H. ECKER, JOHN W. STEDMAN and REEVE SCHLEY, constituting the INSTITUTIONAL BONDHOLDERS COMMITTEE,
Petitioners,

vs.

WESTERN PACIFIC RAILROAD CORPORATION, a corporation; A. C. JAMES CO., a corporation; THE RAILROAD CREDIT CORPORATION, a corporation; THE WESTERN PACIFIC RAILROAD COMPANY, a corporation; IRVING TRUST COMPANY, a corporation, as substituted Trustee under the General and Refunding Mortgage of Western Pacific Railroad Company; RECONSTRUCTION FINANCE CORPORATION; and CROCKER FIRST NATIONAL BANK OF SAN FRANCISCO and SAMUEL ARMSTRONG, as Trustees under the First Mortgage of The Western Pacific Railroad Company, a corporation,
Respondents.

BRIEF FOR INSTITUTIONAL BONDHOLDERS COMMITTEE, PETITIONERS

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

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September 14, 1942.

INDEX

CASES CITED

PAGE

PAGE

PAGE

PAGE

TEXT AUTHORITIES

PAGE

MISCELLANEOUS CITATIONS

STATUTES[1]

[1]Citations to Section 77 of the Bankruptcy Act are too frequent to enumerate. Pertinent portions of Section 77 are printed in Appendix A.

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BRIEF FOR INSTITUTIONAL BONDHOLDERS COMMITTEE, PETITIONERS[1]

On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

OPINIONS BELOW

This case involves a plan of reorganization formulated and approved by the Interstate Commerce Commission in a proceeding for the reorganization of The Western Pacific

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[1]Messrs. Frederick H. Ecker, John W. Stedman and Reeve Schley, Petitioners, constitute a Committee representing a Group of Institutional Holders of the First Mortgage Bonds of The Western Pacific Railroad Company, the Debtor, organized pursuant to the provisions of Section 77(p) of the Bankruptcy Act [11 U. S. C. § 205(p)]. The Committee was permitted to inter-

Railroad Company under Section 77 of the Bankruptcy Act (11 U. S. C. § 205).[1] The Commission's various Reports and Orders are reported at 230 I. C. C. 61, 233 I. C. C. 409 and 236 I. C. C. 1.[2]

The opinion of the District Court for the Northern District of California, Southern Division, accompanying its Order entered August 15, 1940, approving the Commission Plan is reported at 34 F. Supp. 493.[3]

The opinion of the Circuit Court of Appeals, dated November 28, 1941, reversing the District Court, is reported at 124 F. (2d) 136.[4]

JURISDICTION

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 [28 U. S. C. § 347(a)], and Section 24(c) of the Bankruptcy Act [11 U. S. C. § 47(c)].

The Decree of the Circuit Court of Appeals for the Ninth Circuit was entered November 28, 1941.[5] By order

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vene in the proceeding before the Interstate Commerce Commission by order entered July 9, 1936 (R. 2620) and in the proceeding before the District Court by order entered November 27, 1939 (R. 2620). The members of the Group are John Hancock Mutual Life Insurance Company; Metropolitan Life Insurance Company; Mutual Benefit Life Insurance Company; New York Life Insurance Company; Prudential Insurance Company of America; Travelers Insurance Company; and The Chase National Bank of the City of New York. Their aggregate holdings of First Mortgage Bonds are $16,641,400, principal amount, out of a total of $49,290,100, or 34%.

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[1]The plan of reorganization is hereinafter called the Commission Plan, the Interstate Commerce Commission is hereinafter called the Commission and The Western Pacific Railroad Company is hereinafter called the Debtor. Pertinent portions of Section 77 are printed in Appendix A.

[2]R. 194, 300, 884. [3]R. 1569 and 1600, respectively.

[4]R. 2663. [5]R. 2675-6.

filed February 12, 1942, as amended by order of February 16, 1942, said Decree was amended in a manner not relevant to the present issues.[1] Petition for writ of certiorari was filed by the Committee on December 20, 1941, and was granted on April 27, 1942. This Court also granted writs of certiorari to the Trustees under the First Mortgage of the Debtor (No. 8), the Trustee under the General and Refunding Mortgage of the Debtor (No. 61), Reconstruction Finance Corporation (No. 33), and the Debtor (No. 20). No issue is raised on any of these writs which is not raised by the writ granted to the Committee.

QUESTIONS PRESENTED

Four broad questions are presented:

1. Are the findings of the Commission and the District Court that the existing stock and unsecured debt of the Debtor "have no value," sufficient to sustain the exclusion of such stock and unsecured debt from participation in the reorganization, without a specific dollars and cents valuation of the Debtor's entire properties?

2. Are the determinations by the Commission and the District Court of the "equitable equivalent of the Debtor's assets available for the satisfaction" of each class of participating claims, in terms of the various new securities, sufficient to sustain such allocations, without dollars and cents valuations of (i) the properties upon which the mortgages are, respectively, first liens, (ii) each of the several classes of old securities and (iii) each of the several classes of new securities?

3. Did the District Court properly recognize the jurisdiction of the Commission under Section 77 and, in

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[1] R. 2681-3.

the exercise of an informed and independent judgment, fully perform the Court's functions under Section 77?

4. Should this Court, upon the entire record, reverse the Decree of the Circuit Court of Appeals and affirm the Order of the District Court approving the Commission Plan?

A further question is also before the Court:

5. Are securityholders who have defended in the Circuit Court of Appeals a plan promulgated and approved by the Commission, and also approved by the District Court, liable for the costs of the successful appeal, or should such costs be assessed directly against the Debtor's estate?

STATEMENT

The Debtor has paid no interest on its First Mortgage Bonds since September 1, 1933.[1] To provide time both to determine how severe was the Debtor's financial problem and to work out through voluntary negotiation a definitive reorganization plan, the two semi-annual installments maturing in 1934 were extended by voluntary arrangement, but they were not met at their extended maturity.

The Debtor filed its petition under Section 77, on August 2, 1935.[2] The proceedings before the Commission culminated September 28, 1939, in the certification of the Commission Plan to the District Court.[3]

1. Present Capitalization of the Debtor[4]

The existing claims against, and interests in, the Debtor dealt with by the Commission Plan, including interest accrued to the effective date of the Commission Plan, January 1, 1939, computed at the contract rates, are as follows:

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[1]R. 58. [2]R. 4, 11. [3]R. 1571. [4]R. 1576

Claim or Interest	Principal of claim or interest	Accrued interest at contract rate to January 1, 1939	Total claim, including interest at contract rate to January 1, 1939
Trustees' Certificates (RFC)	$ 10,000,000.00	$ —	$ 10,000,000.00
Undisturbed existing equipment obligations	2,750,050.00	34,672.00	2,784,722.00
First Mortgage 5% Bonds	49,290,100.00	13,143,776.66	62,433,876.66
RFC[1] Notes[2]	2,963,000.00	899,869.98	3,862,869.98
RCC[1] Notes[2]	2,445,609.88	145,314.23	2,590,924.11
ACJ[1] Notes[2]	4,999,800.00	1,249,950.00	6,249,750.00
Total secured debt	$ 72,448,559.88	$15,473,582.87	$ 87,922,142.75
WP Corp.[1] and Western Realty Co.[3] advances on open account	5,818,791.00	1,992,096.00	7,810,887.00
Total debt	$ 78,267,350.88	$17,465,678.87	$ 95,733,029.75
WP Corp., owner of the entire outstanding 283,000 shares of Preferred Stock, par value $100 per share	28,300,000.00	—	28,300,000.00
WP Corp., owner of the entire outstanding 475,000 shares of Common Stock, par value $100 per share	47,500,000.00	—	47,500,000.00
Totals	$154,067,350.88	$17,465,678.87	$171,533,029.75

[1]Hereinafter the following abbreviations are used: RFC—Reconstruction Finance Corporation; RCC—Railroad Credit Corporation; ACJ—A. C. James Co.; WP Corp.—Western Pacific Railroad Corporation.

[2]The RFC Notes, the RCC Notes, and the ACJ Notes are collectively secured, in the specific amounts hereinafter stated, by all of the $18,999,500, principal amount, of the Debtor's Refunding Bonds. No Refunding Bonds have been issued except for such pledge. Except for certain securities specifically pledged with the Trustee of the Refunding Mortgage, the Commission and the District Court found the lien of the Refunding Mortgage to be junior to that of the First Mortgage.

The RFC Notes are secured by the pledge of $10,750,000 of said Refunding Bonds and by a second lien upon $2,000,000 of Refunding Bonds pledged under the RCC Notes.

The RCC Notes are secured by the pledge of $4,000,000 of Refunding Bonds, of which $2,000,000 were repledged with it by ACJ, and by a second lien on all the collateral pledged with RFC.

The ACJ Notes are secured by the pledge of $4,249,500 of Refunding Bonds and by a second lien upon $2,000,000 of Refunding Bonds originally pledged under the ACJ Notes but repledged by ACJ under the RCC Notes.

In addition, both the RFC Notes and the RCC Notes are secured by certain so-called "accommodation collateral," not owned by the Debtor, but pledged to secure said Notes by WP Corp. The RCC Notes are also secured by a first lien on the Debtor's distributive share in the fund established by the Marshalling and Distributing Plan, 1931. The right of RFC and RCC to resort to this collateral is not affected by the Commission Plan (R. 271, 394-5).

[3]Western Realty Co. is a wholly owned subsidiary of WP Corp., and a small part of the unsecured debt of the Debtor stands in its name.

2. Earnings Record of the Debtor's Properties[1]

The consolidated earnings available for interest of the Debtor and its subsidiaries for the years 1922 to 1941, both as reported and as adjusted, are set out in the following table. Adjustments have been made first, to add back to reported income all the charges against income account for the rehabilitation expenditures made during 1927-31 and 1934-8 and all charges for amortization of discount; second, to take into account deductions and credits made by the Commission in accordance with its accounting rules and regulations; and third, in the case of the 1940 and 1941 earnings, to take into account Federal income (*but not excess profits*) taxes which would be payable in respect of such earnings if the Commission Plan had been in effect during those years.

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[1]R. 1592. The Debtor's mileage comprises 924 miles of main line track from Oakland, California to Salt Lake City, Utah, and approximately 112 miles of main line track connecting the Debtor's main line with the lines of the Great Northern in north central California. It also includes branch lines aggregating approximately 119 miles. The Debtor also owns (in addition to substantially valueless and unimportant securities) substantially all of the outstanding capital stock and indebtedness of Sacramento Northern Railway (an electric line of 276 miles operating in general between San Francisco and the Sacramento Valley) and Tidewater Southern Railway Company (an exclusively freight line of 61 miles operating in the San Joaquin Valley); and fractional interests in the securities of Central California Traction Company (an electric line of about 54 miles between Stockton and Sacramento, California) and the Alameda Belt Line (a 16 mile belt line at Alameda, California).

Year	Earnings Available for Interest[1] Reported	As Adjusted
1922	$2,306,124	$2,404,890
1923	3,313,976	3,412,234
1924	3,144,124	3,241,823
1925	4,454,352	4,567,798
1926	4,759,282	4,868,390
1927	2,674,494	3,470,861
1928	2,964,371	4,376,972
1929	2,529,846	3,718,436
1930	1,552,487	2,381,529
1931	186,708(D)	220,494(D)
1932[2]	252,706	283,912
1933	674,007	474,365
1934[3]	1,084,244	1,396,353
1935	805,589	1,377,026
1936	181,102	1,901,423
1937	903,113(D)	1,077,407
1938	1,243,916(D)	225,431
1939	1,384,515	1,519,916
1940	2,649,797	2,361,620[4]
1941	4,548,138	3,587,674[4]

(D) Deficit

[1]R. 1064-6, 2629, 2635. The adjusted figure of $4,412,234 for 1923 contained in the Stipulation before the District Court is an obvious typographical error. See R. ~~2626~~ 2036

[2]The Northern California Extension was put into operation November 10, 1931, so that the properties covered by this earnings record from 1932 on are the same properties as those to be acquired by the reorganized company. That Extension (112 miles) forms a connection in north central California between the main line of the Debtor, at a point 281 miles from San Francisco, with a branch of the Great Northern running southward through central Oregon into northern California. It created a new north-south route over the combined lines of the Great Northern and the Debtor, and further southward over the Santa Fe, competitive with the Southern Pacific System.

[3]The Dotsero Cut-off was put into operation in 1934. It is a 38 mile line, a part of the lines, not of the Debtor, but of the Denver & Rio Grande, one of the Debtor's connections, which resulted in shortening by 175 miles the joint route of the Debtor and the D & R G from Salt Lake City into Denver.

[4]These figures are after deducting Federal income taxes payable on 1940 and 1941 earnings under the capitalization contemplated by the Commission Plan. Adjusting reported earnings for such taxes upon the basis of the Debtor's present capitalization, but disregarding losses aggregating $2,799,265 incurred in prior years and claimed by the Debtor to be deductible for the purpose of computing 1941 taxes, the adjusted earnings for 1940 would be the same as reported earnings, and for 1941 $4,315,834. If such deductions for antecedent losses claimed by the Debtor are allowable, they will so reduce 1941 earnings as to result in no Federal income taxes for that year. Computations of these taxes are set forth in Appendix B. *No adjustment of 1941 earnings has been made for any possible Federal excess profits tax.* Whether such earnings may be subject to such a tax depends upon tax legislation not yet enacted.

The earnings for the years 1922 to 1938 were before the Commission and are as found by the Commission; those for 1939 were before the District Court; and those for 1940 were before the Circuit Court of Appeals. Those for 1941 are computed from the monthly statements of earnings which by stipulation filed July 23, 1942, the parties agreed may be considered by this Court.

In considering the overall picture presented by these earnings it must be borne in mind that the $9,268,373 of rehabilitation expenditures added back to the adjusted earnings for the years 1927-31 and 1934-8 represent deferred maintenance which had accrued prior to 1927.[1] The exact amount of the accruals of such deferred maintenance for the various years prior to 1927 cannot be computed with any accuracy, but as *no* adjustment has been made in the foregoing table to take into account such deferred maintenance for the prior years, the earnings of those years, even as adjusted, are necessarily overstated by a substantial amount.

3. New Capitalization under the Commission Plan

The Commission Plan provides the following capital structure for the reorganized company, effective as of January 1, 1939,[2] the Commission, as hereinafter pointed out, having found upon consideration of all the various factors affecting the value of the Debtor's property, that no

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[1]R. 1052, 1063, 1065, 1214. [2]R. 1575.

larger capitalization was compatible with the public interest:[1]

Title of issue	Presently to be issued	Annual charges
Undisturbed existing equipment obligations	$ 2,750,050	$ 94,202
First Mortgage 4% Bonds, Series A, due January 1, 1974	10,000,000	400,000
Total annual fixed charges		$ 494,202
Mandatory Capital Fund		500,000
Income Mortgage 4½% Bonds, Series A, due January 1, 2014. Interest cumulative to 13½%, otherwise non-cumulative. Convertible at the option of the holder into new Common Stock at the price of $50 per share	21,219,075	954,858
Total funded debt	$33,969,125	
Total annual charges (fixed and contingent) and Capital Fund		$1,949,060
Income Mortgage Sinking Fund (½%)		106,095
Participating 5% Preferred Stock ($100 par value). Preferred on liquidation to extent of par value plus any accrued cumulative dividends. Dividends cumulative only to the extent earned in any calendar year but not paid; otherwise non-cumulative. Participating share for share with Common Stock in dividends declared in any year after dividends have been declared on Common Stock at rate of $3 per share	31,850,297	1,592,515
Total securities with par value	$65,819,422	
Total annual charges, Capital Fund, and Preferred dividend requirements		$3,647,670
Common Stock (without par value)	319,441 shs.	

[1] R. 889-90.

4. Distribution under the Commission Plan

The Trustees' Certificates were sold to RFC early in the reorganization proceeding to provide $10,000,000 for rehabilitation of the Debtor's properties and elimination of the substantial amount of deferred maintenance hereinbefore referred to.[1] Those Certificates are admittedly secured by a first lien upon all the assets of the Debtor and the Trustees.[2]

The claim of the First Mortgage to a first lien, subject to the Trustees' Certificates, upon substantially all the Debtor's assets, except the securities of certain subsidiary corporations specifically pledged with the Refunding Mortgage Trustee,[3] was disputed. Likewise disputed was the value of the collateral pledged under the Refunding Mortgage. In allocating the new securities, the Commission preliminarily decided the disputed lien questions in favor of the First Mortgage, subject to ultimate determination by the District Court.[4] The Commission also decided the disputed value questions.

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[1]R. 1834-6. [2]R. 1836.

[3]In 1934, pursuant to an agreement extending the payment of 1934 interest on the Debtor's First Mortgage Bonds, RFC, ACJ, RCC and WP Corp. (the only other creditors affected by the Commission Plan) agreed to subordinate their claims against the Debtor until this 1934 interest (still unpaid) is paid in full. Accordingly the case presents no problem as to the relative rights of senior and junior creditors in unmortgaged assets. I. C. C. Exhibits 117-121 (not printed pursuant to stipulation at R. 2532-8, 2614, but before this Court pursuant to stipulation filed on July 23, 1942).

[4]R. 262. The District Court affirmed the Commission's determination of the lien questions but, although the propriety of the District Court's action was raised upon appeal (R. 1652-3), the Circuit Court of Appeals failed to decide any of these questions. Their final determination by this Court is sought not only under the writ granted the Committee, but also under the writs granted

The Commission then found that "the equity of the existing stock has no value," that "the claims of the unsecured creditors have no value," that the securities allocable to the RFC Notes, RCC Notes, and ACJ Notes are "inadequate in value to satisfy their claims," and that "the equity of" RCC in the collateral pledged under the RFC Notes "has no value."

After making the additional findings hereinafter stated, the Commission excluded from participation in the reorganization the unsecured claims and stock held by WP Corp. and Western Realty Co., and distributed the new capitalization as follows:[1]

Existing Securities of Debtor[2]	New First Mortgage 4% Bonds Series A	New Income Mortgage 4½% Bonds Series A	New 5% Preferred Stock Series A ($100 Par)	New Common Stock (No Par)
First Mortgage 5% Bonds ($62,433,876.66)		$19,716,040	$29,574,060	230,593 shs.
RFC (In exchange for Trustees' Certificates and RFC Notes) ($13,862,869.98)	$10,000,000	1,185,200	1,777,800	15,788 shs.
RCC Notes ($2,590,924.11)		154,111	241,681	35,425 shs.
ACJ Notes ($6,249,750)		163,724	256,756	37,635 shs.
Totals	$10,000,000	$21,219,075	$31,850,297	319,441 shs.

The existing First Mortgage 5% Bonds are allotted new Income Mortgage 4½% Bonds for 40% of the principal

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the First Mortgage Trustees and the Refunding Mortgage Trustee. Separate briefs are being filed in respect of the lien questions, and this brief in its further discussion will assume the correctness of the decisions of the Commission and the District Court.

[1] R. 1578.

[2] The figures in this column include accrued interest to January 1, 1939.

amount of their claim, new 5% Preferred Stock for 60% of the principal amount of their claim and 4.67 shares of new Common Stock for the $266.67 of accrued interest per $1,000 bond.[1] The price at which the Common Stock was so allotted is therefore $57 per share.[2]

RFC, in consideration of its exchanging its $10,000,000 of Trustees' Certificates for $10,000,000 of new, less valuable, First Mortgage Bonds, is allotted treatment in respect of the RFC Notes *pari passu* with the treatment allotted the First Mortgage Bonds.[3]

RCC and ACJ are allotted new securities on the following basis:

Because of the first lien of the Refunding Mortgage on the securities specifically pledged with the Refunding Mortgage Trustee, the Commission found certain amounts of new Income Mortgage Bonds and Preferred Stock properly issuable in respect of the Refunding Mortgage Bonds held as collateral for the RFC, RCC and ACJ Notes.[4] The Commission allotted to the RCC Notes and the ACJ Notes amounts of these Income Mortgage Bonds and Preferred Stock in the proportions that the amounts of Refunding Bonds pledged with them, respectively, bore to the total amount of Refunding Bonds.[5]

All the new Common Stock not previously allocated necessarily represented (1) the value of the second lien of the Refunding Mortgage upon those assets of the Debtor upon which the First Mortgage is a first lien and (2) any hope for future value of the assets upon which the Refunding Mortgage is a first lien but which the Commission found

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[1]R. 390. [2]R. 391. [3]R. 391. [4]R. 312-6. [5]R. 391-2.

to be of "no material value."[1] The Commission divided this remaining new Common Stock between RCC[2] and ACJ, again in proportion to the amounts of Refunding Bonds held by them, respectively, as collateral.[3]

5. Valuation Data before the Commission

The Commission Plan was formulated by the Commission itself after more than a dozen different plans had been proposed by the various parties and upon evidence occupying 743 pages of the record. This evidence included

physical descriptions of the properties of the Debtor and each of its subsidiaries,[4]

comprehensive data concerning valuation proceedings affecting those properties conducted by the Commission under Section 19(a) of the Interstate Commerce Act,[5]

analyses of the Debtor's investment accounts[6] and its financial history,[7]

detailed studies of revenues and expenses for the years since 1922, broken down as among the Debtor and its subsidiaries,[8]

detailed forecasts of revenues and earnings for the then future years 1936 to 1940, also broken down as among the Debtor and its subsidiaries,[9] and

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[1]R. 315.

[2]To cover the RCC Notes in full, taking new senior securities at par, this stock must attain a value of at least $62 per share.

[3]R. 317-8, 392. [4]R. 1861-3, 1886-98, 2049-60.

[5]R. 2019, 2044-8.

[6]R. 1874-5, 1885-94, 2019, 2040-3, 2058-60. [7]R. 1859-73.

[8]R. 1958, 2033-92, 2121-8, 2239-60.

[9]R. 1950, 1959-98, 2027-32, 2118-93.

testimony with reference to the probable effect upon revenues and net income of the $10,000,000 rehabilitation program,[1] of the Northern California Extension[2] and of the Dotsero Cut-off.[3]

6. Findings Made by the Commission

After hearings, the Commission's Bureau of Finance served upon all the parties a Tentative Report proposing findings and a reorganization plan.[4] Following exceptions to this Tentative Report and a hearing before the full Commission, the Commission entered its Report and Order dated October 10, 1938, making findings and approving a plan of reorganization.[5] Upon petitions for modifications of this Report and Order and another hearing before the full Commission, the Commission entered its Report and Order dated June 21, 1939,[6] modifying both the findings and the plan of reorganization embodied in its earlier Report and Order and approving the Commission Plan. After a petition by the Debtor for a "further rehearing and modification," the Commission entered its Report and Order dated September 19, 1939,[7] reaffirming its findings and conclusions of October 10, 1938, as modified June 21, 1939, and denying the Debtor's petition.

The Commission defined the requirements of "the public interest" with respect to the new capital structure as follows:

> "The public interest is not defined, but it would seem obvious that to be compatible with the public interest, the plan must provide a capital structure

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[1]R. 1985-6, 2145-52, 2172-85, 2225-33.
[2]R. 1942-8, 2094-8, and see description *supra*, p. 7, note 2.
[3]R. 1939, 2099-2100, and see description *supra*, p. 7, note 3.
[4]R. 116. [5]R. 194. [6]R. 300. [7]R. 884.

> for the reorganized company which will give it a reasonable opportunity to function efficiently and continuously as a going concern. This requires that the capitalization should not exceed a conservative appraisal of the assets to be taken over by the reorganized company, and that proposed charges, whether fixed or contingent, be within its probable earning power."[1]
>
> "If this reorganization is to be successful, the capital structure of the reorganized company must be realistically related to its actual earning power, and consideration given to the investment in its property only to the extent that such investment is justified by the probable earnings reasonably foreseeable for the future."[2]

After pointing out that the Debtor was the product of a previous equity reorganization of its properties in 1916, the Commission made the following fundamental finding as to the prudence of the Debtor's investment in its property:

> "The present reorganization of the debtor is the second since it began complete operations in 1911. A review of its financial history shows that due to an inherent lack of earning power its past operations have resulted in financial failure, and that the investment in its property has not been justified by its earnings. In Denver & Rio Grande Investigation, 113 I. C. C. 75, we pointed out that economically the original construction of the debtor was an ill-advised undertaking."[3]

The Commission then made the following findings which the Circuit Court of Appeals for the Ninth Circuit has now held to be inadequate:

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[1]R. 243-4. [2]R. 244. [3]R. 244.

(a) *Findings as to capitalization*

1. "If these data [*i.e.* earnings] are not to be ignored, * * * the fixed interest charges of the reorganized company should not * * * exceed $500,000, if the reorganized company is to maintain its property properly and secure necessary new capital in the future."[1]

2. "On the basis of the facts heretofore recited with respect to traffic and earnings, we find that the total annual fixed and contingent interest charges of the reorganized company, plus requirements for the capital and sinking funds, should not exceed $2,000,000 per annum."[2]

3. "As hereinbefore stated, the debtor's estimate of income available for interest averaged $2,715,306 per year for the period 1936-40, inclusive, the maximum amount for any one year in the period (1940) being $3,769,836. That amount, with prior charges of $1,898,223, would permit the payment of dividends at the rate of 5 percent on only $37,432,000 of stock. It is obvious, therefore, that based on the most optimistic estimate of earnings of record, the capitalization of the reorganized company must be maintained within strict limits if any material return on its capital stock is to be expected and the shares of its stock are not to become mere tokens for stock market speculation. It is true that considered alone, the data pertaining to the rate-making value of the debtor's property, and its investment, would support capitalizations approximating those proposed in the three plans. We have hereinbefore stated, however, the reasons why, in our opinion, those factors can not be of controlling importance in a determi-

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[1]R. 246. [2]R. 253.

nation of the capital structure for the reorganized company. Considering all relevant data of record, we find that the approved plan should provide for the immediate issue by the reorganized company of not to exceed" the amounts of Preferred and Common Stock provided by the Commission Plan.[1]

4. On the basis of the foregoing findings the Commission fixed the permissible new capitalization.[2] Twice it found that it could not approve any larger capitalization.[3]

(b) *Finding as to classes excluded from participation*

5. "We have hereinbefore found that considering the past, present, and probable future earnings of the debtor, its investment, the data of record pertaining to its rate-making value, and all other relevant data of record, we can not approve the issue of new securities in a greater amount than that hereinbefore approved. On the same basis and for the same reasons we find, therefore, that there is no equity over and above the securities hereinbefore approved; that *the equity of the existing stock has no value,*[4] and hence holders of such stock are not entitled to participate in the plan. Further, considering that the reorganized company's income available for interest and dividends must total $4,318,035,[5] plus any undistributed profits tax that will be payable, before dividends of $3 per share may be paid on the new common stock, it is clear that *even*

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[1]R. 257. The amounts of Preferred and Common Stock originally found permissible were slightly increased in the final Commission Plan (R. 310-311).

[2]R. 259, 310. [3]R. 310, 889-90.

[4]All italics in quoted matter throughout this brief have been supplied, unless the contrary is indicated.

[5]Under the final Commission Plan this became $4,605,993.

though all the securities remaining available for distribution after satisfying the claims of the first-mortgage bondholders are allotted to the other secured creditors, such securities will be inadequate in value to satisfy their claims. For this reason, and for the reasons stated with respect to the finding that the equity of the existing stock has no value, we find that *the claims of the unsecured creditors,* of the Western Pacific Railroad Corporation, and of the Western Realty Company, *have no value,* and hence no securities or cash should be distributed under the plan in respect to those claims."[1]

(c) *Findings as to distribution of new securities*

6. The Commission found that all of the permissible new fixed charge securities would be absorbed by undisturbed equipment obligations and new First Mortgage Bonds required to pay or refund the admittedly preferred $10,000,000 Trustees' Certificates.[2]

7. The Commission found that the first lien of the First Mortgage (subject to the Trustees' Certificates) upon all of the assets of the Debtor, except cash and securities specifically held in pledge by the Refunding Trustee, required allocation to the First Mortgage of the new securities allocated by the Commission Plan as above stated.[3]

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[1]R. 269-70. The Commission had no problem of dealing with the rights of unsecured creditors to participate in unmortgaged assets. See p. 10, n. 3, *supra.*

[2]R. 247, 311.

[3]R. 270, 317. The original allocation by the Report and Order dated October 10, 1938, was modified by the Report and Order dated June 21, 1939, by increasing the no par value Common Stock originally allocated to the First Mortgage as against accrued interest, and by allocating Income Bonds and Preferred Stock to the Refunding Bonds, as stated in paragraph 8, *infra.*

8. The securities pledged under the Refunding Mortgage were a note and stock of Tidewater Southern Railway Company, all of whose funded debt and 97.87% of whose stock are owned and so pledged by the Debtor,[1] bonds and stock of Central California Traction Company, of which the Debtor owns and has pledged 33⅓%,[2] and stock of Alameda Belt Line, of which the Debtor owns 50% and has pledged 49.4%,[3] plus some admittedly worthless notes of other subsidiaries.[4] The Commission analyzed the property accounts, earnings records and earnings prospects of these three companies. In the light of the contributions which the Debtor has been compelled to make to continue the operations of the last two mentioned companies[5] and their poor earnings record, the Commission found that "the lien on the securities of these two companies *has no material value.*"[6] As to Tidewater Southern, the Commission found its rate-making value as of December 31, 1935, to be $1,850,000 (1.3% of the comparable System valuation).[7] Reported earnings and the revenues from traffic interchanged between it and other lines of the Debtor's System were also analyzed.[8] Such reported earnings for the six-year period 1930-1935[9] were 7.2% of System earnings as adjusted,[10] before deducting the Debtor's contributions to the deficits of the other two Refunding Mortgage first lien properties.[11] But, said the Commission, "its earnings are, to a large extent, dependent upon the divisions of joint

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[1]R. 313. [2]R. 314. [3]R. 315. [4]R. 1095.

[5]These unreimbursed contributions totalled more than $384,000 for the six years 1930-1935 (R. 2019, 2084, 2088).

[6]R. 314-5. [7]R. 314. [8]R. 314. [9]R. 2019, 2077. [10]R. 1592.

[11]R. 2019, 2084, 2088.

rates accorded it by the debtor."[1] After the foregoing findings and after reference to the cash held by the Refunding Mortgage Trustee,[2] the Commission found that the Refunding Mortgage should be allotted $732,010 new Income Mortgage Bonds and $1,147,995 new Preferred Stock[3] (being 3.5% of the total issues), and all the Common Stock remaining after provision for the First Mortgage.

9. The RFC Notes, the RCC Notes, and the ACJ Notes were secured by pledge, respectively, of 56.6%, 21.1%, and 22.3% of the outstanding Refunding Bonds. The Commission found that the securities "available for distribution are *inadequate in value to satisfy the aggregate claims of these parties,*"[4] that "the value of each of the claims is proportionate to the collateral securing it," and hence that the allotment of new securities representing the pledged Refunding Bonds "should be made on the basis of the collateral held rather than on the amount of the claims."[5]

10. "The allocation of reorganization securities" to the RFC Notes collateral "exhausts the value of the collateral,"[6] and * * * *"the equity of the Credit Corporation* [RCC] *in such collateral has no value."*[7]

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[1]R. 315. It will be remembered that the Debtor owns all the funded debt and 97.87% of the outstanding stock of Tidewater Southern Railway Company, so that the fairness of these rate divisions was not a matter of importance except in reorganization.

[2]R. 313. [3]R. 315. [4]R. 271. [5]R. 271.

[6]The Commission here was referring only to the new securities allotted to RFC's pledged Refunding Bonds, *i.e.* it was not including the additional new securities allotted to RFC in consideration of its furnishing new money as explained in paragraph 12, *infra.*

[7]R. 316.

11. On the basis of the findings referred to in the foregoing paragraphs 8, 9 and 10, the Commission allotted to the RCC Notes and the ACJ Notes the Income Bonds and Preferred Stock found by the Commission to be allocable as against their respective pledged proportions of the Refunding Bonds. The no par value Common Stock remaining after filling out the existing First Mortgage Bonds with 230,593 shares against their accrued interest of $13,143,777, and allotting the RFC Notes treatment as stated in the next paragraph 12, was then also allocated to the RCC Notes and ACJ Notes proportionately to the Refunding Bonds held by them as collateral.

12. To insure refunding of the $10,000,000 Trustees' Certificates, RFC was allotted, for its entire "bundle of rights" (its $10,000,000 Trustees' Certificates and the RFC Notes), $10,000,000 of new First Mortgage Bonds (to be taken in exchange for the Trustees' Certificates or to be purchased at par and the proceeds thereof applied to payment of the Trustees' Certificates) and treatment of the RFC Notes *pari passu* with the existing First Mortgage Bonds. The Commission found "that in consideration of such purchase and the value of the collateral securing its claim, the Finance Corporation receive for the secured notes of the debtor held by it, treatment equal to that accorded the holders of the debtor's existing first-mortgage bonds."[1]

13. The ultimate finding of the Commission was: "These securities [*i.e.*, all the new securities available for distribution] represent the equitable equivalent of the debtor's assets available for the satisfaction of claims. * * * *Based upon our conclusion as to the relative priority, value,*

[1] R. 312.

and equity of the various claims and the value of the new securities available in exchange therefor, we find that the new securities should be allotted"[1] as provided in the Commission Plan.

The Commission did not specifically find any specific value in terms of dollars and cents for all or any part of the Debtor's property, for any of the existing claims against or interests in the Debtor, or for any of the new securities contemplated by the Commission Plan.

7. Proceedings before the District Court

Upon certification of the Commission Plan to the District Court, objections and claims for equitable treatment were filed by RCC, ACJ, WP Corp., Western Realty Company, the Debtor, and the Refunding Trustee, which attacked, as to both form and substance, substantially every provision of the Commission Plan.[2] Their objections went primarily to alleged undue discrimination in favor of the First Mortgage Bonds and the RFC Notes as against all the junior interests. Although the Committee and RFC also filed some objections and claims for equitable treatment, each of them stated that if the District Court approved the Commission Plan as an entirety they would waive their objections and both of them urged such approval.[3]

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[1]R. 316-7.

[2]The details of these objections (R. 892-1017) are so voluminous, complicated and contradictory, and the extent to which many of them were pressed in the Circuit Court of Appeals is so ambiguous, that no useful purpose will be served by attempting to analyze them at this point of this brief. Such of them as seem to the Petitioners to merit consideration by this Court in determining its ultimate disposition of the entire case upon the entire record will be discussed at the relevant points of the argument.

[3]R. 1760-1, 1770.

Before the District Court, testimony was taken occupying 293 pages of the record embodying substantial additional valuation data.[1] On August 15, 1940, the District Court filed a 31 page opinion overruling all of the objections and, after dealing specifically with the Commission's findings of value, determining them to be adequate in form and correct in substance.[2] The District Judge's opinion further expressed his accord, on the merits, with all of the conclusions of the Commission on the numerous other points in dispute.

Pursuant to its opinion, the District Court, on August 15, 1940, entered an Order approving the Commission Plan, adopting the findings of fact made by the Commission, and making all the other findings in respect of the Commission Plan required at that stage of the proceedings by Section 77.[3]

8. Action of the Circuit Court of Appeals

From the Order last mentioned appeals were taken to the Circuit Court of Appeals for the Ninth Circuit by RCC, ACJ, the Refunding Mortgage Trustee, WP Corp., and the Debtor. Again the appellants attacked almost every aspect of the Commission Plan, although many of the objections argued before the District Court seem to have been abandoned. The emphasis of their briefs and arguments was upon alleged failure (1) of the Commission to make necessary findings of value of properties and securities, old and new, and (2) of the District Court to exercise an independent informed judgment. The Commit-

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[1]R. 1283-1529, 1530-1567. [2]R. 1569-1600. [3]R. 1600-1607.

tee, the First Mortgage Trustees and RFC, designated as appellees, defended the Commission Plan as an entirety.

The Circuit Court of Appeals reversed the Order of the District Court.[1] Without referring to any of the extensive findings of the Commission above recited, or the careful discussion by the District Court of the problems of value, the Circuit Court of Appeals thus disposed of the case:

> "Subsection (e) of § 77 provides: 'If it shall be necessary to determine the value of any property for any purpose under this section, the [Interstate Commerce] Commission shall determine such value and certify the same to the court in its report on the plan.' In this case, as has been seen, it was necessary to determine the value of (1) the debtor's entire property, (2) each of the claims of Reconstruction Finance Corporation, (3) the claim of Railroad Credit Corporation, (4) the claim of A. C. James Company, (5) the claims of the holders of first mortgage bonds now outstanding, (6) the $10,000,000 of new first mortgage bonds, (7) the $21,219,075 of income bonds, (8) the 318,502.97 shares of new preferred stock, (9) the 319,441 shares of new common stock, (10) the property subject to the first mortgage now outstanding, (11) the $18,999,500 of refunding bonds pledged to secure the claims of Reconstruction Finance Corporation, Railroad Credit Corporation and A. C. James Company, (12) the other collateral pledged to secure each of said claims, (13) the property subject to the refunding mortgage only, (14) the property subject both to the refunding mortgage and to the first mortgage now outstanding, (15) the property which would be subject to the new first mortgage and (16) the property which would be subject

[1] R. 2663-74.

> to the income mortgage. It thus became the duty of the Commission to determine these values and certify them to the court. That duty was not performed."[1]

In addition to this holding, the opinion of the Circuit Court of Appeals announced this guiding rule for distribution among existing securityholders: "Fairness requires that their participation should be in proportion to the value of their respective claims."[2] The opinion does not further clarify its announced rule. Taken in connection with its holding above quoted, requiring specific dollars and cents valuations, the Circuit Court of Appeals thus seems to require distribution based upon a mathematical formula derived from dollars and cents valuations of properties, existing claims, and new securities, rather than distribution based upon a determination of the equitable equivalents of the participating existing claims in the system assets and earnings, expressed in terms of the new securities.

The opinion of the Circuit Court of Appeals also commented on the functions of the court and the Commission in effecting a railroad reorganization under Section 77.

The opinion of the District Court, in addition to expressing the District Judge's own independent analysis of the valuation problem and his own independent conclusions, had said:

> "It cannot be gainsaid that the Commission knows all about the Debtor, its property, its history, financial and otherwise, its traffic and revenue, and its financial structure. No official body in the country is better qualified, by reason of experience, ability

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[1]R. 2670-1. [2]R. 2669.

> and specialized knowledge than is the Commission to find the ultimate facts as to the Debtor in relation to any of the matters mentioned."[1]

Quoting the foregoing statement of the District Court, the opinion of the Circuit Court of Appeals stated:

> "The statement indicates a possible misconception. * * *
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> * * * * * * *
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> "In determining whether a plan of reorganization satisfies the requirements of subsection (e), the court is not concluded by any determination made by the Commission, but may, and must, exercise its own independent judgment; and this is true whether such determination relates to value or to some other subject."[2]

The significance of this comment of the Circuit Court of Appeals, as evidencing its belief that the District Court was under a duty to redetermine *all* of the issues involved in the reorganization and assert its own "independent judgment" if in any respect its views differed from those of the Commission, is accentuated by the fact that the District Court, following the quotation commented on by the Circuit Court of Appeals, had said:[3]

> "The two issues of (1) amount and character of capitalization and (2) distribution of new securities are closely related. The determination of the amount and character of the capitalization (a legislative function affecting the public interest) is exclusively within the province of the Commission. The only qualification, if any, is that the court shall independently determine whether, in the exercise of

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[1]R. 1588.
[2]R. 2672-4. [3]R. 1596-7.

its jurisdiction, the Commission has acted fairly, within the bounds of the Constitution, and not arbitrarily. The determination of the questions relating to the distribution of the new securities, including legal priorities and allocations, involves private rights and is a judicial function, within the province of the court."

ARGUMENT

I

THE FINDINGS OF THE COMMISSION AND THE DISTRICT COURT THAT THE DEBTOR'S STOCK AND UNSECURED DEBT "HAVE NO VALUE," AS SUPPORTED BY THE VALUATION DATA AND THE OTHER FINDINGS IN THE RECORD, ARE SUFFICIENT TO SUSTAIN THE EXCLUSION OF SUCH STOCK AND UNSECURED DEBT FROM PARTICIPATION IN THE REORGANIZATION.

1. The Los Angeles Lumber Case[1] and the Consolidated Rock Products Case[2]

The Court below rested its decision upon what is believed to be an erroneous interpretation of those two decisions of this Court.

Prior to those two decisions the legal periodicals for more than a decade had filled many pages with controversial discussion as to the validity of two alleged "rival" or "competing" theories of priority rights in reorganization, one called "the theory of absolute priority" and the other

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[1]*Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (1939).

[2]*Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510 (1941).

"the theory of relative priority."[1] The two decisions have been hailed as marking the final establishment of the "absolute priority" theory and the "demise of the relative priority theory."[2]

But doubt continues as to what is meant, not only by "absolute priority," but by many other words and phrases of the two opinions.

On the simple facts involved the two decisions were clear. Neither of the plans involved could be justified except by the brutal "composition theory" that substantially any settlement for which stockholders could procure the statutory assents of creditors was "fair and equitable." However, two points as to which there had been substantial controversy were decided: (1) that the words "fair and equitable" in Section 77B and Chapter X, being words of art, import into reorganization under those sections the standards of the so-called rule of the *Boyd* case,[3] and hence that the principles applicable to ordinary bankruptcy compositions are inapplicable to such reorganizations; and (2) that interest on creditors' claims accruing but unpaid after the initiation of the reorganization proceeding is included in the amount of the claims whose priority must be fully observed.

The opinions also broadly discussed the principles applicable to the recognition of the priority rights of cred-

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[1]Compare Bonbright and Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization* (1928) 28 Col. L. Rev. 127, and Rostow and Cutler, *Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act* (1939) 48 Yale L. J. 1334.

[2]Comment (1941) 51 Yale L. J. 85, 86.

[3]*Northern Pacific Ry.* v. *Boyd*, 228 U. S. 482 (1913).

itors both as against stockholders and as between separate classes of creditors.

The following summary of the relevant portions of those opinions is given to bring into focus words and phrases as to whose meaning debate persists.

It is not enough, says the Court in the *Los Angeles Lumber* case, that "the *relative priorities*[1] * * * are maintained." The rule is one of *"full or absolute priority."*[2] But the opinion approves the dictum of the *Boyd* case

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[1]Throughout these quotations italics have been added to indicate the words or phrases whose meaning is disputed.

[2]It is not desired to bestir a ghost. However, the story of "the relative priority theory" evidences the dangerous ambiguities inherent in such pat phrases and words as "relative priorities," "absolute priority," "full payment," "full compensation," "make whole," "findings" and, worst of all, "value."

As early as 1882 the United States District Court for the Northern District of Illinois, in *Hancock* v. *Toledo, P. & W. R. Co.*, 9 Fed. 738, at 742, approved a railroad reorganization on the ground that it seemed to "fairly contemplate the protection of all classes of creditors of the old company in the equitable order of their priority."

In 1927 a Lecture before the Bar Association of the City of New York sought to trace judicial treatment of the problem of securityholders' priorities through subsequent decisions leading up to the historic *Boyd* case and the larger number of decisions subsequent to the *Boyd* case. These later cases had largely involved railroad reorganizations, in all of which the stocks involved not only had antecedent records of substantial earning power but evidenced a recovery of earning power following the reorganization.

The Lecture (27 Col. L. Rev. 901, 907, and 8 Lectures on Legal Topics 133, 142) made the mistake of trying to reduce a complex problem to a concise rule without adequate definition of the words and phrases employed: "The rule as I see it, and as I believe it will ultimately be developed by the courts, is that the relative priorities of the old securities, senior to the most junior securities which continue to have any interest in the property, must not be inequitably disturbed."

A host of lances appeared from the halls of legal learning to

that this rule does not "require the impossible and make it necessary to pay an unsecured creditor in cash as a condi-

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do to death any such "rule."

On the one hand, Frank (overlooking that the Lecture did not purport to derive the "rule" solely from the *Boyd* case) insisted that the *Boyd* case depended solely upon the rule with respect to fraudulent conveyances and therefore furnished no basis whatever for the Lecture's statement that it applied as between any securities other than creditors on the one hand and stockholders on the other (*Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541, 551-3). In this he was seconded by Gerdes (II Gerdes on Corporate Reorganizations (1936) §1085, and *General Principles of Plans of Corporate Reorganization* (1940) 89 U. Pa. L. Rev. 39, 48 *et seq.*), and Glenn (Glenn on Liquidation (1935) §436). This criticism, however, went only to the accuracy of the Lecture's citations of judicial precedent. The reorganization amendments to the Bankruptcy Act, with the cooperation of several of these critics, adopted the Lecture's "rule" that a reorganization plan must be "fair and equitable" as between all classes of securities.

The more persistent and effective attack on the Lecture's "rule," however, was from an entirely different angle. Bonbright (Bonbright and Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization* (1928) 28 Col. L. Rev. 127) set up two antithetic theories, one of which he called "the relative priority theory" and the other "the absolute priority theory." To more easily destroy it, he defined the former, whose origin he ascribed to the Lecture above referred to, as contemplating the perpetuation of the entire old hierarchy of securities no matter how clearly it might be established that some of the more junior among them were entirely without value. (See also Gerdes, *General Principles of Plans of Corporate Reorganization, supra,* at p. 58.) In this he overlooked both the phrase of the Lecture "junior securities which continue to have any interest in the property" and also the fact that the Lecture had expressly stated that the relative priorities might be fully observed in a simplified capital structure. The rule of "absolute priority," as stated in antithesis, contemplated that each class of senior securities, starting at the top, must be given in reorganization new securities having a "value" (and the context indicates intent to mean market price) equal to its full

tion of stockholders retaining an interest in the reorganized company. His interest can be preserved by the issuance, on

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principal and interest before anything can be given to the next junior class. The authors of the article, however, recognized that neither theory as thus stated had ever been applied by any court (and they might have added, advocated by any responsible lawyer), and so they concluded with advocacy of "a modified form of the doctrine of relative position."

With the evaporation of corporate earnings in the depression of the early 30's, and particularly with the enactment of Sections 77 and 77B as part of "An Act for the Relief of Debtors," the "relative priority theory" sank into extreme degeneracy. It lost all semblance to the "rule" above quoted from the Bar Association Lecture and even assumed a new name, the "composition theory" (Rostow and Cutler, *Competing Systems of Corporate Reorganization: Chapters X and XI of the Bankruptcy Act* (1939) 48 Yale L. J. 1334, 1356). The theory, as thus developed, urged that the principles of old-fashioned bankruptcy composition should govern reorganizations under the new sections. It sought to impose all the sacrifices of reorganization on senior interests for the benefit of junior interests. "Relative priorities" were regarded as "maintained" if some part of the creditors' claim preserved seniority over the allotment to stockholders and if the reduction of the creditor interests did not exceed, percentage-wise, the reduction of the stockholder interests. (Note (1938) 23 Wash. U. L. Q. 543, 544).

It must have been with this last-mentioned meaning content that the opinions of this Court in the *Los Angeles Lumber* and the *Consolidated Rock Products* cases both say: "True, the relative priorities * * * are maintained" (308 U. S. 106, 119; 312 U. S. 510, 527), for in the former case creditors received nothing for 75% of their claim, and in the latter nothing for their accrued interest. That this was a use of the expression "maintenance of relative priorities" in a sense entirely in conflict with that of the early use of the term has been pointed out by Dodd (*The Los Angeles Lumber Products Company Case and its Implications* (1940) 53 Harv. L. Rev. 713, 733, n. 48).

Any "rule" or "theory" capable of such prostitution obviously merited an even earlier "demise."

The moral to be drawn from this history is that the "absolute priority theory" must be bulwarked with accurate definitions of the words and phrases which give it expression if it is not also to experience distortion.

equitable terms, of income bonds or preferred stock." However, a class of securityholders may not "be perpetuated in the new company" if "the assets [are] insufficient to *pay*—in new bonds or stock—the amount owing senior creditors." "The value to the bondholders * * * of avoiding litigation with the old stockholders" does not justify "the inclusion of the latter in the plan," for, says the Court, "the strategic or nuisance value of such parties * * * is irrelevant * * *. In these proceedings there is no occasion for the court to yield to such pressures." This, however, does not prevent compromise of "conflicting claims to specific assets which may * * * be more wisely settled by compromise rather than by litigation."

In the *Consolidated Rock Products* case, where no serious effort had been made in the District Court to develop the valuation data necessary under this Court's earlier decisions,[1] this Court pointed out that *"absent the requisite valuation data,* the court was in no position to exercise the 'informed, independent judgment' * * * which appraisal of the fairness of a plan of reorganization entails. * * * *No adequate finding was made as to the value of the assets* * * *. * * * *a determination of that value must be made* so that criteria will be available *to determine an appropriate allocation* of new securities * * *."

As to "the method of valuation" the opinion stressed the necessity that the lower court "value the whole enterprise by *a capitalization of prospective earnings.*" It pointed out that "a sum of values based on physical factors and assigned to separate units of the property without regard to

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[1] *National Surety Co.* v. *Coriell,* 289 U. S. 426 (1933); *First National Bank* v. *Flershem,* 290 U. S. 504 (1934).

the earning capacity of the whole enterprise is plainly inadequate." This fact was "emphasized by the poor earnings record of this enterprise in the past." "Unless meticulous regard for earning capacity be had, indefensible participation of junior securities" might result.

The rights of the creditors were not "satisfied even though the 'relative priorities' of creditors and stockholders were maintained."[1] The bondholders must be *"made whole."* Their loss of their former senior fixed charge position through allotment of "an inferior grade of securities" necessitates that *"full compensatory* provision * * * be made for the entire bundle of rights which the creditors surrender." But "the absolute priority rule does not mean that bondholders cannot be given inferior grades of securities, or even securities of the same grade as are received by junior interests." Feasibility, presumably public interest in the case of a railroad, permits "practical adjustments" and dispenses with the necessity of a "rigid formula," but for surrendering senior rights creditors must receive *"full compensatory treatment,"* and they "are entitled to have the *full value* of the property, whether 'present or prospective, for dividends or only for purposes of control,' first appropriated to *payment* of their claims. * * * So long as *the new securities offered are of a value equal to the creditors' claims,* the appropriateness of the formula employed rests in the informed discretion of the court. * * * So long as they receive *full compensatory treatment* and so long as each group shares in the securities of the whole enterprise on an equit-

[1]As pointed out above, "relative priorities" were "maintained" in the Consolidated Rock Products Plan only in a most loose and inaccurate sense.

able basis, the requirements of "fair and equitable" are satisfied."

If the opinions in these two cases are read in the light of their entire content, without detaching particular words and phrases and giving them meanings inconsistent with their context, the opinions would seem to constitute a clear chart for reorganization.

Unhappily, however, the controversy as to the proper method of dealing with the priorities of creditors seems not to have been settled.[1] On the one hand junior interests, relying upon the two opinions, have belied this Court's assurance that there is no occasion for senior securityholders to yield to "pressures" from junior interests by insisting (as here successfully before the Circuit Court of Appeals) upon specific dollars and cents findings of value of properties, old claims and new securities. On the other hand, it has been insisted that the two opinions establish that the most senior classes of creditors must first receive "*payment*" in new securities having a presently realizable *market value* or *worth* equal to the full amount of their claims before anything can remain for distribution to junior classes.[2]

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[1]See Note (1940) 49 Yale L. J. 1099, 1102.

[2]That the *Consolidated Rock Products* case established such a rule was asserted by Professor Gerdes in an article in the New York Herald Tribune of March 9, 1941, Section II, p. 11, col. 3; Prentice-Hall Bankr. Serv., Report Letter No. 15, (March 26, 1941), in contradiction of his earlier view, expressed in *General Principles of Plans of Corporate Reorganization* (1940) 89 U. Pa. L. Rev. 39, 47. Fear that such a rule has been established was expressed by Dean, *A Review of the Law of Corporate Reorganizations* (1941) 26 Cornell L. J. 537, 559, n. 63. But see Gilchrist, *"Fair and Equitable" Plan of Reorganization: A Clearer Concept* (1941) 26 Cornell L. J. 592, 617.

2. The Meaning of "Value" as Used in Section 77

The 1935 amendments to Section 77 incorporated in subsection (e) the following definition:

> "The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

(a) Rate-making value; depreciated investment; depreciated reproduction cost

The chief author of the 1935 amendments, Mr. Leslie Craven, has said:[1]

> "The purpose of these provisions is * * * to incline the determination away from the doctrine of *Smyth* v. *Ames,* under which the value is fixed on the basis of a consideration of the original and reproduction cost of the property and the investment therein. The actual value of the property cannot be determined, nor is it ordinarily evidenced by the investment in the property or its present cost of construction. The railroads are competitive properties. The value of their operative property, for purposes of reorganization, must necessarily be what, for better terms, we may call the actual value or the economic worth of the property, as de-

[1] Craven and Fuller, *The 1935 Amendments of the Railroad Bankruptcy Law* (1936) 49 Harv. L. Rev. 1254, 1274.

termined primarily by its present and prospective earning capacity. The actual value of the property depends upon the demand for its service and its ability to meet the demand economically. The provisions of the amended statute, therefore, make clear that emphasis shall be put on a consideration of earning power, past, present, and prospective."

The statute thus expressly adopted, with perhaps an unnecessary cautious nod at *Smyth* v. *Ames*,[1] the rule of "valuation for reorganization purposes" which had uniformly been adopted in the old equity reorganizations of railroads,[2] and which was later declared by this Court to be applicable to reorganizations under Section 77B.[3]

Yet notwithstanding this express provision of Section 77, the Western Pacific junior interests urged before the Commission that in determining both permissible capitalization and the distribution of new securities in the reorganization, controlling weight must be given to the elements of physical value evidenced by depreciated reproduction cost and depreciated investment. Notwithstanding this Court's intervening decision in the *Los Angeles Lumber* case, they persisted in this contention before the District Court. Even after this Court had made its contrary position doubly clear in the *Consolidated Rock Products* case, they urged before the Circuit Court of Appeals that the judicial test taboos

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[1]169 U. S. 466 (1898). Compare *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575 (1942).

[2]*Temmer* v. *Denver Tramway Co.*, 18 F. (2d) 226, 229 (C. C. A. 8th, 1927); *New York Trust Co.* v. *Continental & Commercial Trust & Savings Bank*, 26 F. (2d) 872, 874 (C. C. A. 8th, 1928); *cf. Atlanta, Birmingham & Coast R. R.* v. *U. S.*, 296 U. S. 33, 38 (1935).

[3]*Case* v. *Los Angeles Lumber Products Co., Ltd.*, *supra*; and *Consolidated Rock Products Co.* v. *DuBois*, *supra*.

the use of regulated earnings as proof of value" of a railroad[1] and argued that this was so because the Commission's control over the Debtor's rates results in a hopeless "downward spiral" wherein earning power determines value, value determines rates, and rates in turn determine earning power.[2]

This persisting error of the Western Pacific junior interests is due to a not uncommon failure to recognize the truism by Mr. Justice Brandeis, that "value is a word of many meanings."[3] Its meaning in connection with any specific problem must depend upon the character of the problem involved and the purpose for which "value" is being determined.[4]

The problem of determining the amount at which the property of a railroad company or other utility may fairly be taxed, *i.e.*, its taxable "value;" the problem of determining fair compensation for the property of a railroad or other utility taken over by a governmental authority, *i.e.*, its condemnation "value;" and, most clearly of all, the prob-

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[1]Debtor's brief in C. C. A., p. 58.

[2]WP Corp. brief in C. C. A., p. 65.

[3]*Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U. S. 276, 310 (1923).

[4]Thorough and illuminating discussions of the necessity for a "purposive" determination of the meaning of the word "value" are to be found in Bonbright, *The Problem of Judicial Valuation* (1927) 27 Col. L. Rev. 493; Bonbright and Pickett, *Valuation to Determine Solvency Under the Bankruptcy Act* (1929) 29 Col. L. Rev. 582; Spaeth and Windle, *Valuation of Railroads Under Section 77 of the Bankruptcy Act* (1938) 32 Ill. L. Rev. 517. These articles contain exhaustive collections of the decisions of this Court, as well as of the lower Federal Courts, establishing the soundness of the statement of the text and the unsoundness of the perhaps contrary dictum of Mr. Justice Butler in *Great Northern Ry.* v. *Weeks*, 297 U. S. 135, 139 (1936).

lem of determining the rates which a railroad or other utility may fairly charge, *i.e.*, its rate-making "value," are not at all the problem of determining how a financially defunct railroad or other utility shall be recapitalized and its new securities fairly distributed among its old creditors and stockholders, *i.e.*, the reorganization "value" of the property, the old securities and the new securities. As the Securities and Exchange Commission aptly put it in a utility reorganization under Section 77B:[1] "Valuation for rate-making purposes is not the same. There the question is how much the utility will be allowed to earn—if it can. Here the question is how much can it earn—even if allowed."

In every railroad reorganization case which has come before it under Section 77, the Interstate Commerce Commission, while considering elements of physical value and including in the "valuation data" full studies of depreciated investment and depreciated cost of reproduction, has refused to treat those elements as controlling, and has determined both the capitalization of the reorganized company "compatible with the public interest" and the rights of existing securityholders to participation, primarily upon the basis of the future earning power of the venture reasonably to be foreseen.[2]

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[1] *In the Matter of Genesee Valley Gas Company, Inc.*, 3 S. E. C. 104, 112, n. 19 (1938).

[2] *Akron, Canton & Youngstown Ry.*, 228 I. C. C. 645 (1938); *Chicago & Eastern Illinois Ry.*, 230 I. C. C. 199 (1938), 230 I. C. C. 571 (1939); *Chicago Great Western R. R.*, 228 I. C. C. 585 (1938), 233 I. C. C. 63 (1939); *Chicago, Milwaukee, St. Paul & Pacific R. R.*, 239 I. C. C. 485 (1940), 240 I. C. C. 257 (1940); *Chicago & North Western Ry.*, 236 I. C. C. 575 (1939), 239 I. C. C. 613 (1940); *Chicago, Rock Island & Pacific Ry.*, 242 I. C. C. 298 (1940), 247 I. C. C. 533 (1941); *Denver & Rio Grande Western R. R.*, 233 I. C. C. 515 (1939), 239 I. C. C.

The standards of "value for reorganization" thus adopted by the Commission have been approved by the United States District Courts in every case which has come before them,[1] and in the only decisions of the Circuit Courts of Appeals which have discussed the point.[2] Indeed, the decision of the Circuit Court of Appeals for the Ninth Circuit here under review can afford the Western Pacific junior interests no support for their insistence upon the

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583 (1940), (Finance Docket No. 11002, July 13, 1942, not yet reported); *Erie R. R.*, 239 I. C. C. 653 (1940), 240 I. C. C. 469 (1940); *Florida East Coast Ry.* (Finance Docket No. 13170, April 6 and August 10, 1942, not yet reported); *Minneapolis, St. Paul & Sault Ste. Marie Ry.*, (Finance Docket No. 11897, March 17 and June 17, 1942, not yet reported); *Missouri Pacific R. R.*, 239 I. C. C. 7 (1940), 240 I. C. C. 15 (1940); *New York, New Haven & Hartford R. R.*, 239 I. C. C. 337 (1940), 244 I. C. C. 239 (1941); *St. Louis-San Francisco Ry.*, 240 I. C. C. 383 (1940), 242 I. C. C. 523 (1940); *St. Louis Southwestern Ry.*, 249 I. C. C. 5 (1941), 252 I. C. C. 325 (1942); *Spokane International Ry.*, 228 I. C. C. 387 (1938), 233 I. C. C. 157 (1939); *Western Pacific R. R.*, 230 I. C. C. 61 (1938), 233 I. C. C. 409 (1939), 236 I. C. C. 1 (1939).

[1] *In re Akron, Canton & Youngstown Ry.* (N. D. Ohio 1939, not reported); *In re Chicago & Eastern Illinois Ry.* (N. D. Ill. 1940, not reported); *In re Chicago Great Western R. R.*, 29 F. Supp. 149 (N. D. Ill. 1939); *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 36 F. Supp. 193 (N. D. Ill. 1940); *In re Chicago & North Western Ry.*, 35 F. Supp. 230 (N. D. Ill. 1940); *In re Denver & Rio Grande Western R. R.*, 38 F. Supp. 106 (D. Colo. 1940); *In re Erie R. R.*, 37 F. Supp. 237 (N. D. Ohio 1940); *In re Missouri Pacific R. R.*, 39 F. Supp. 436 (E. D. Mo. 1941); *In re New York, New Haven & Hartford R. R.* (D. Conn., Dec. 8, 1941, not yet reported); *In re Western Pacific R. R.*, 34 F. Supp. 493 (N. D. Calif. 1940).

[2] *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 124 F. (2d) 754 (C. C. A. 7th, 1941); *In re Chicago & North Western Ry.*, 126 F. (2d) 351 (C. C. A. 7th, 1942); *Akron, Canton & Youngstown Ry. Co.* v. *Hagenbuch*, 128 F. (2d) 932 (C. C. A. 6th, 1942).

controlling effect of physical value, for that Court's opinion is silent as to the standards of "value" to be employed in the many "findings" of "value" which it requires.

Similarly, the Securities and Exchange Commission, in acting upon reorganizations of public utilities under Section 11(f) of the Public Utility Holding Company Act and under Chapter X of the Bankruptcy Act, has uniformly adhered to the view that "for purposes of reorganization as distinguished from 'value for rate-making purposes' earning power becomes in the final analysis a paramount criterion."[1]

Whether a reorganization be that of a railroad or other utility or that of an industrial company, a capitalization must be found which fairly represents the prospective earning power of the property involved. That capitalization must then be distributed in such manner as to give each of the old creditors and stockholders, to the extent that they have any interest represented by such earning power, the "equitable equivalent" of their contractual rights. The

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[1] *In the Matter of Genesee Valley Gas Co., Inc.*, 3 S. E. C. 104, 112 (1938); *In the Matter of West Ohio Gas Co.*, 3 S. E. C. 1014, 1019 (1938); *In the Matter of National Radiator Corp.*, 4 S. E. C. 690, 695 (1939); *In the Matter of The Griess-Pfleger Tanning Co.*, 5 S. E. C. 72, 76 (1939); *In the Matter of Utilities Power & Light Corp.*, 5 S. E. C. 483, 500 (1939); *In the Matter of La France Industries*, 5 S. E. C. 917, 926 (1939); *In the Matter of San Francisco Bay Toll-Bridge Co.*, 6 S. E. C. 863, 873 (1940); *In the Matter of Flour Mills of America, Inc.*, 7 S. E. C. 1, 9 (1940); *In the Matter of Deep Rock Oil Corp.*, 7 S. E. C. 174, 181 (1940); *In the Matter of Porto Rican American Tobacco Co.*, 7 S. E. C. 301, 305 (1940); *In the Matter of Minnesota and Ontario Paper Co.*, 7 S. E. C. 456, 476 (1940); *In the Matter of The Higbee Co.*, 8 S. E. C. 777, 782 (1941); *In the Matter of McKesson & Robbins, Inc.*, 8 S. E. C. 853, 858 (1941); *In the Matter of the Philadelphia and Reading Coal and Iron Co.*, S. E. C. Corp. Reorg. Rel. No. 55 (July 25, 1942).

opinion of this Court in the *Consolidated Rock Products* case took no distinction between industrials and utilities in its declaration:

> "Whether or not the earnings may reasonably be expected to meet the interest and dividend requirements of the new securities is a *sine qua non* to a determination of the integrity and practicability of the new capital structure. It is also essential for satisfaction of the absolute priority rule * * *." (p. 525.)

It is significant that the earlier authority quoted in the *Consolidated Rock Products* opinion, as evidencing that the rule there laid down was nothing new, was the statement of Mr. Justice Holmes with reference to a railroad property in *Galveston, Harrisburg & San Antonio Ry.* v. *Texas*, 210 U. S. 217, 226 (1908): "* * * the commercial value of property consists in the expectation of income from it."

(b) MARKET VALUES

As "value for rate-making purposes" cannot be the basis of a "value for reorganization purposes" *inflated* beyond the limits of a fair capitalization of prospective earning power, neither should the "market value," whether of the properties themselves, or of the old claims, or of the new securities issuable in the reorganization, *deflate* the "value for reorganization purposes" below that reasonably justified by a liberal estimate of future earning capacity.

It has been pointed out both by this Court and by the commentators that as a practical matter a railroad system

has no "market value."[1] Accordingly, those who believe that "valuation for reorganization purposes" is the same thing as "market value" would apply the "absolute priority rule" by attempting to determine the prospective "market values" of the new securities issuable in the reorganization and applying such market values toward payment of the full face amounts of old claims in order of seniority.[2] There is in fact no "market" for such new securities during the long period elapsing between the original proposal of plans in a railroad reorganization proceeding and the ultimate confirmation of a plan. Hence determination of the "market value" or, to use Gerdes' expression, the "worth" of the new securities is sheer guess work.

It would be of immediate advantage to the present First Mortgage Bonds of the Western Pacific were such a rule to be applied to the Western Pacific reorganization, for it would result in the allotment to them, as the most senior security, of most, if not all, of the Common Stock allotted by the Commission Plan to the RCC Notes and the ACJ Notes. The Committee, however, recognizes that wholly unjust confiscation of actual values for reorganization purposes would result from the application of any such rule.

If any such test were to be applied to determine whether or not a class of creditors or stockholders should be excluded from a Section 77 reorganization, the same test

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[1] *Louisville Trust Co.* v. *Louisville, New Albany & Chicago Ry.*, 174 U. S. 674, 683 (1899); *Northern Pacific Ry.* v. *Boyd*, 228 U. S. 482, 504 (1913).

Bourne, *Findings of "Value" in Railroad Reorganizations* (1942) 51 Yale L. J. 1057, 1068; Weiner, *Conflicting Functions of the Upset Price in a Corporate Reorganization* (1927) 27 Col. L. Rev. 132, 137; Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541, 554-5.

[2] See p. 34, n. 2, *supra*.

would necessarily apply to the determination of "insolvency." By such a test hardly any railroad in the United States would be solvent today. As of July 1, 1942, the aggregate "market value" of the entire capital structure of the New York Central Railroad Company, including its $626,190,200 principal amount of debt, was $429,211,979; that of the Southern Pacific Company, with $375,232,117 principal amount of debt, was $288,561,456; that of the Northern Pacific Railway Company, with $324,283,000 principal amount of debt, was $212,073,750; and that of the Southern Railway Company, with $279,142,500 principal amount of debt, was $267,904,430. Upon the basis of market value of securities all those properties would have to be treated as insolvent. Yet in 1941 the New York Central earned $4.07 per share on its Capital Stock; the Southern Pacific System $9.16 per share; the Northern Pacific $3.13 per share; and the Southern Railway $12.61 per share upon its Common Stock after full provision for its Preferred Stock; and it is common knowledge that 1942 per share earnings of all those properties are at a substantially increased rate.[1]

Neither the Interstate Commerce Commission nor the Securities and Exchange Commission, nor any of the courts in passing upon plans approved by either of the two Commissions, has intimated that "market value" of either the old securities or the new securities was any test of the aggregate "value for reorganization purposes." In its report on the *Cotton Belt* case, decided since the *Western Pacific* decision below, the Commission has expressly re-

[1]The debt structures and per share earnings thus stated have been computed from Moody's Manual and the respective companies' annual reports; market prices have been taken from the Commercial & Financial Chronicle.

fused to accept "market values" as affording "a proper basis for the reorganization of railroads for the long future term."[1] The constant references to "earning capacity" in this Court's opinion in the *Consolidated Rock Products* case and its direction that the lower court should "value the whole enterprise by a capitalization of prospective earnings," seem to negative the "market value" test.

(c) Capitalization of Prospective Earning Power

In the Courts below the Western Pacific junior interests were concerned at the failure of the Commission to find a specific number of dollars and cents as the Debtor's prospective earnings and then to capitalize them at a specified rate.

In dealing with this problem of the rate at which earnings should be capitalized for reorganization purposes, the Securities and Exchange Commission has applied, to some definite estimate of earning power, rates ranging from 4½% to 12%, depending upon the facts of each case.[2]

The approach of the Interstate Commerce Commission to this problem seems more appropriate to the case of a

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[1] *St. Louis Southwestern Ry.*, 252 I. C. C. 325, 356 (1942).

[2] *In the Matter of West Ohio Gas Co.*, 4 S. E. C. 377 (1939) (6%); *In the Matter of Mountain States Power Co.*, 5 S. E. C. 1 (1939) (6% to 7%); *In the Matter of McKesson & Robbins, Inc.*, 8 S. E. C. 853 (1941) (8.7%); *In the Matter of The Griess-Pfleger Tanning Co.*, 5 S. E. C. 72 (1939) (10%); *In the Matter of San Francisco Bay Toll-Bridge Co.*, 6 S. E. C. 863 (1940) (10%); *In the Matter of Porto Rican American Tobacco Co.*, 7 S. E. C. 301 (1940) (10%); *In the Matter of Minnesota and Ontario Paper Co.*, 7 S. E. C. 456 (1940) (10%); *In the Matter of Flour Mills of America, Inc.*, 7 S. E. C. 1 (1940) (12%); *In the Matter of Atlas Pipeline Corp.*, SEC Corp. Reorg. Release No.

large railroad property such as that of the Debtor. The Commission recognizes, as did this Court in its opinion in the *Consolidated Rock Products* case,[1] that the prognostication of future earnings cannot be precise but must be an approximation only. Furthermore, as any estimate of prospective earnings increases to amounts exceeding past earnings, it becomes increasingly more speculative. Hence, while in many cases the Commission has had before it expert testimony as to hypothetical "earnings for a future normal year," and while it has discussed such testimony in relation to its approved capitalization, the Commission has not predicated aggregate capitalization generally, or solely, on any fixed rate of capitalizing a fixed dollars and cents estimate of future annual earnings.[2] It has been its practice, broadly speaking, after full analysis of past and

42 (June 7, 1941) (12%); *In the Matter of Sayre & Fisher Brick Co.*, SEC Corp. Reorg. Release No. 47 (September 12, 1941) (12%). See also Note (1941) 55 Harv. L. Rev. 125, 133; and *In the Matter of Utilities Power & Light Corp.*, 5 S. E. C. 483 (1939) (4½% to 5%).

[1] 312 U. S. 510, at p. 526.

[2] In fourteen reorganization cases before the Commission in which definite estimates of future average annual earnings are referred to, the Commission has approved capitalizations which in effect capitalized such prospective average annual earnings in twelve cases at rates ranging from 2.90% in the *Milwaukee* case, 239 I. C. C. 485, 515, 539 (1940), to 4.14% in the *Fonda, Johnstown and Gloversville* case, 249 I. C. C. 455, 469-70, 473 (1941). In the thirteenth case, *Akron, Canton & Youngstown Ry.*, 228 I. C. C. 645 (1938), the approved capitalization is equivalent to the capitalization at 5% of the rough average between the prospective average annual earnings as testified to by the debtor and by the bankruptcy trustee. In the fourteenth case, *Chicago & Eastern Illinois Ry.*, 230 I. C. C. 199, 230-1 (1938), the Commission capitalized at 5% prospective average annual earnings estimated at an amount unusually high with reference to average past earnings as well as actual 1941 earnings and the 1942 estimate.

present earnings and factors which may make prospective earnings either larger or smaller than those of the past,[1] to make a liberal aggregate estimate of "prospective earnings" divided roughly into four classifications:

1. Those reasonably certain to continue without serious interruption, with a sufficient excess to provide for new fixed charge obligations the "adequate coverage" required by Section 77 for fixed charges.[2] Against these earnings the Commission has permitted the issue of new fixed charge obligations, usually with an interest rate of 4%.

2. Those of which there is substantial probability but whose regular annual continuance cannot be counted upon in a period of general business depression. Against these additional earnings the Commission has permitted the issue of contingent interest bearing obligations, usually with an interest rate of 4½%.

3. Those of which there is reasonable probability, but which, on the basis of the past earnings record, may frequently be interrupted. Against these additional earnings the Commission has permitted the issue of Preferred Stock, usually with a 5% dividend rate.

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[1]Such as the opening of the Northern California Extension and the Dotsero Cut-Off in the case of the Western Pacific. See R. 210, 215, and remarks of Commissioner Eastman, Transcript of hearings before Judiciary Committee on S. 1869 (76th Cong. 2nd Sess. 1939) 551-3.

[2]"A plan of reorganization * * * shall provide for fixed charges * * * in such an amount that, after due consideration of the probable prospective earnings of the property in light of its earnings experience and all other relevant facts, there shall be adequate coverage of such fixed charges by the probable earnings available for the payment thereof * * *."—Subsection (b) of Section 77.

4. Those of which there is no probability of uninterrupted realization but which will probably be realized from time to time and, if optimistic hopes are fulfilled, may ultimately be maintained. Against these additional earnings, together with the potential increment to the ultimate equity arising from the operation of any Capital Fund or Sinking Fund, the Commission has permitted the issue of Common Stock, which it has usually allotted at a price requiring a 6% dividend to make whole the most senior existing securities to which it is allotted.

This practical approach, if fairly applied in the light of all the "valuation data" offered by the affected securityholders, will produce, it is submitted, a capital structure for a reorganized railroad, and an aggregate "value for reorganization purposes," not only meeting the requirements of the public interest, but also adapted to recognizing fully the priorities, "relative" and "absolute," of the various classes of securities.

3. Suggested Standard for Determining, as to any Class of Securityholders, the Necessity for its Admission to, or its Exclusion from, Participation in a Section 77 Reorganization

Out of his abundance of experience Commissioner Eastman has observed:

> "Any estimate of the future earnings of a railroad can at best be no more than an 'educated guess' * * *. Anything remotely approaching accuracy is impossible."[1]

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[1]Transcript of hearings before Judiciary Committee on S. 1869 (76th Cong. 2nd Sess. 1939) 551.

To attempt to fix a precise number of dollars and cents as representing future earning power of a railroad and in turn to capitalize that earning power at a fixed rate into a precise number of dollars and cents reorganization value would be sheer unrealistic pretense. There can be no absolute and fixed dollars and cents figure marking a point of earning power or of reorganization value on one side of which, were the earnings or reorganization value a penny more, a class of creditors or stockholders must be admitted to participation in reorganization if its own rights are not to be violated, and on the other side of which, were the earnings or reorganization value a penny less, the same class must be excluded if the rights of senior classes are not to be violated.

Under the old equity practice, prior to Section 77, the securityholders' representatives, as "reorganizers," determined by "bargaining" what marginal classes of creditors or stockholders might be admitted to participation in reorganization, and the terms of such admission, subject to court approval of the result as "fair and equitable" and to Commission approval of the proposed new capitalization as "compatible with the public interest." The opinion has currently been often expressed that senior creditors were too merciful to junior classes or too yielding to their "pressures."

Section 77, as administered by the Commission, has substituted the Commission as the "reorganizer" and its expert judgment for the old "bargaining" among the securityholders. That substitution cannot, however, make certainty out of educated guess work. In the implications of such certainty in some of their words and phrases lie the possible ambiguities of the opinions in the *Los Angeles Lumber* and *Consolidated Rock Products* cases.

With recognition of the dangers inherent in any formula, the following is submitted as a standard for determining, as to any class of creditors or stockholders, the *necessity* for its admission to, or its exclusion from, participation in reorganization:

If, upon all the relevant valuation data, it is affirmatively established that earning power will, on the average over reasonable periods, probably be sufficient, not only to insure full coverage of the existing contractual income rights of senior classes and ultimate cash recovery of the full amount of the claims of such senior classes, but also to provide some surplus of earnings available to service the junior class, then such demonstrated *presence* of earning power (*i.e.*, value for reorganization purposes) for the junior class compels its admission to participation if its own rights are not to be violated.

If, on the other hand, upon all the relevant valuation data, it is affirmatively established that there is no reasonable probability of earning power to provide such income coverage and ultimate full cash recovery for senior classes, then such demonstrated *absence* of earning power (*i.e.* value for reorganization purposes) for the junior class compels its exclusion from participation if the rights of the senior classes are not to be violated.

Between the lines of demonstrated *presence* and demonstrated *absence* of such earning power will inevitably lie a substantial zone within which a class may be admitted without violation of the rights of senior classes, or may be excluded without violation of its own rights.[1] Unless the determination of admission or exclusion by the Commission, as the expert reorganizer under Section 77, is

[1] *Cf.* Gerdes, *General Principles of Plans of Corporate Reorganization* (1940) 89 Pa. L. Rev. 39, 54.

founded upon insufficient valuation data or is clearly arbitrary, it should not be rejected by the court.

Application of the suggested standard in the Western Pacific reorganization, as will be shown in the next succeeding pages, presents no problem of a nice judgment within the possible zone. There is affirmative demonstration of *absence* of earning power for the classes excluded by the Commission Plan.

4. The Commission's Determination of the "Reorganization Value" of the Western Pacific

(a) THE NEGOTIATIONS AMONG THE SECURITYHOLDERS

The A. C. James Co. and its affiliates own, in addition to the ACJ Notes, more than $8,000,000 of First Mortgage Bonds of the Debtor[1] and 8.76% of the outstanding Preferred Stock and 61.2% of the outstanding Common Stock, or 40.36% of all the outstanding capital stock of WP Corp.[2] WP Corp., with its 100% owned subsidiary, Western Realty Company, in turn owns all the unsecured debt and 100% of the Preferred and Common Stock of the Debtor.[3] All of the outstanding Refunding Bonds of the Debtor are pledged under the RFC, RCC and ACJ Notes. The only securityholders of the Debtor who have not appeared in the reorganization proceeding are thus the First Mortgage Bondholders other than those represented by the Committee and ACJ.[4]

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[1]Transcript of oral argument of counsel for A. C. James Co. before the Interstate Commerce Commission, November 17, 1937, p. 788 (not printed in the Record by stipulation, R. 2616, but before this Court pursuant to stipulation filed on July 23, 1942).

[2]R. 1051. [3]R. 1026-7, 1030, 1051.

[4]No other First Mortgage Bondholders than those represented by the Committee and by the James interests have appeared in the reorganization proceeding either before the Com-

Following the default of the Debtor in the payment of its First Mortgage Bond interest in March, 1934, the Committee entered into negotiations with the James interests, RFC and RCC. These negotiations continued after the institution of this reorganization proceeding in August, 1935, and until the final decision of the Commission in June, 1939.[1] Their object was to work out, if possible, a reorganization plan which would be acceptable to the four interests involved, the First Mortgage Bonds, RFC, RCC and the James interests; and at the same time be approved by the Commission.

Both in these negotiations and formally before the Commission, the Committee made its own proposals and supported proposals of other parties, providing for allotments of warrants or of Common Stock for the Debtor's unsecured debt and stock held by WP Corp. Particularly did the Committee support the proposal of RCC[2] (following the Commission's first Report and Order in 1938) that the capitalization be increased beyond that contemplated by the Commission Plan, by adding $18,413,928 of 4% Preferred Stock (largely for allocation against accrued First Mortgage interest), and 30,000 shares of no par value Common Stock in order to permit some participation for WP Corp.

This action of the Committee was not dictated by any belief that the prospective earning power of the Debtor was sufficient to *entitle* the junior interests to any larger participation than that given them by the Commission Plan. Indeed, the Committee recognized that prospective earning power for those junior interests was so extremly remote as

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mission or in the Courts. These scattered small holders are, however, represented by the First Mortgage Trustees to the extent provided in subsection (c)(7) of Section 77.

[1]R. 690. [2]R. 693.

to raise a serious question as to whether the admission of the WP Corp. to any participation, or of the RCC and ACJ Notes to any greater participation than that provided by the Commission Plan, would not violate the rights of First Mortgage Bondholders not represented by the Committee. The Committee recognized, however, that the large and diversified James holdings created serious risk of those "pressures" of which this Court spoke in the *Consolidated Rock Products* case. The Committee therefore felt that a prompt reorganization without continued litigation was of much greater value to the First Mortgage Bondholders than the small amount of Common Stock proposed to be given up.

Despite the urging by all the parties that representatives of the Commission sit informally with them to endeavor to reach a compromise which the Commission might approve, the Commission refused in any way to participate in the negotiations. So, too, the Commission expressly refused to approve any of the proposals of the various parties to give participation to the junior interests beyond that provided by the Commission Plan.

(b) THE COMMISSION'S CONCLUSIONS

Four times, once by its Bureau of Finance and three times by action of the full Commission, the Commission found that "the equity of the existing stock has no value."[1] Three times the full Commission also found that "even though all the securities remaining available for distribution after satisfying the claims of the first mortgage bondholders are allotted to the other secured creditors, such securities will be inadequate in value to satisfy their claims."[2] Hence, the full Commission three times found

[1]R. 269. See also R. 185, 393, 889. [2]R. 269. See also R. 392, 889.

that "the claims of the unsecured creditors * * * have no value."[1]

Upon all the "valuation data" before it (which has been described generally, *supra*, pp. 13-14, and will later be discussed in detail, *infra*, pp. 56-61), the Commission reached the following conclusions as to prospective earning power and the proper new capitalization:

1. The prospective earnings sufficiently certain to meet the statutory standard of "adequate coverage" for fixed charges did not exceed $500,000. Accordingly, it limited fixed charges to the $2,750,050 of undisturbed existing Equipment Obligations and $10,000,000 new First Mortgage 4% Bonds having an aggregate annual fixed charge of $494,202.

2. The prospective earnings found to have sufficient probability to justify contingent debt charges, including sinking funds, and a Capital Fund, did not exceed $2,000,000. Against the approximately $1,000,000 thus left over after fixed charges and a Capital Fund of $500,000, which the Commission found required by the public interest, it permitted the issuance of $21,219,075 Income Mortgage Bonds with 4½% interest, representing an annual contingent charge of $954,858, and with an annual ½% Sinking Fund, representing an annual contingent charge of $106,095, or a total annual contingent debt charge of $1,060,953.

3. The "most optimistic estimate of earnings of record" indicated support for "dividends at the rate of 5% on only $37,432,000 of stock."[2] However, the Commission treated substantially all of that "most optimistic estimate" as being of sufficient probability to justify the

[1] R. 269-70. See also R. 392, 889.
[2] R. 257.

issuance of approximately $31,850,297 par value of Preferred Stock with a 5% dividend, or a total annual dividend charge of $1,592,515.

Thus the Commission created a capital structure with approximately $66,000,000 of par value securities and approximately $3,650,000 annual charges through Preferred dividends.

4. The small amount of earning power remaining, evidenced by "the most optimistic estimate of earnings of record" for any one year ($120,000 on the Commission's figures[1] and $400,000 on the Debtor's figures[2]), together with the capital accretions arising from the Capital Fund and the Income Bond Sinking Fund, the Commission found to be the basis for authorizing the 319,441 shares of no par value Common Stock. It indicated hope that earnings might some day even attain the still higher annual level of $4,600,000, permitting dividends at the rate of $3 per share on the Common Stock,[3] and it allocated the new Common Stock to the senior First Mortgage Bonds at a price of $57 per share.[4]

While the Commission did not state a specific over-all dollars and cents figure thought by the Circuit Court of Appeals to be "necessary to determine the value of the debtor's entire property," the foregoing determinations do include all the figures necessary for a mathematical com-

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[1]As indicated on page 16, *supra*, the Commission adopted a figure of approximately $3,770,000.

[2]The Debtor's highest estimate for any one year was approximately $4,050,000. R. 142, 2019, 2027.

[3]R. 269.

[4]R. 317. One share was allotted for each $57 of accrued interest.

putation of the *maximum amount* of such a "value" for reorganization purposes.

The Commission's allotment of the no par value Common Stock to the First Mortgage Bondholders at $57 per share (particularly in the light of the finding, referred to in Point II of this brief, that the equity of the RCC Notes in the collateral securing the RFC Notes "has no value") was necessarily in substance a finding that the "value for reorganization purposes" of the Debtor's properties *did not exceed* $84,027,559. That is the amount produced by taking all the par value securities, undisturbed and new, at their par values (at which they were allotted against First Mortgage Bond principal and RFC Note principal) and the entire 319,441 shares of no par value Common Stock at $57 per share (the price required to "make whole" the First Mortgage Bondholders and the RFC Notes).[1]

(c) VALUATION DATA

Examination of the "valuation data" upon which the Commission made the determinations set forth above demonstrates that they violate no right of any of the complaining junior interests.

Every conceivable type of valuation data suggested as being relevant by either the Commission or any of the parties was made part of the record before the Commission.[2]

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[1]It should be noted that, even if a $3 annual dividend will cause the Common Stock to be salable at $57 per share and all the new securities senior thereto to be salable at their par value, thus making the old First Mortgage Bondholders whole as to the *principal* amount of their claims, the *annual return* which they will then receive on their entire present claim ($1,266.67 per $1,000 Bond) will be only 4.896% as contrasted with the 5% to which they are now contractually entitled on that amount.

[2]While in their petitions for modification of the Commission's Report and Order of October 10, 1938, both the Debtor and ACJ

Before the District Court all the additional valuation data offered by any of the parties was received by the Court.

This, therefore, is not a case like *Jamieson* v. *Watters*, 91 F. (2d) 61 (C. C. A. 4th, 1937), (relied on below by the objecting junior interests), in which valuation data proffered by the appellants had been excluded. Nor is it like that case or like the *Consolidated Rock Products* case in any sense that there was "absent the requisite valuation data."

(i) *Physical Value.*

Included in the "valuation data" were full records of the valuation of the Debtor's properties under Section 19a of the Interstate Commerce Act in 1929 and as to the original cost of, or investment in, those properties. Full studies of depreciation were also included. They evidenced that the net "value for rate-making purposes" of the Debtor's System as of December 31, 1935, was $139,600,455,[1] that a similar value as of December 31, 1938 was $150,907,623[2] and that its investment in road and equipment (book value), less equipment depreciation, as of December 31, 1938, was $144,978,559.[3]

While the Commission refused to give controlling effect to these elements of value, or even on that basis to approve

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asserted that the record lacked evidence to support the Commission's conclusions, neither they nor any other of the objecting junior interests offered any additional valuation data. On challenge by one of the Commissioners as to what additional evidence could be taken to "arrive at some idea regarding values," the Debtor's counsel stated that he did not believe it "necessary or expedient to reopen the record" (Transcript referred to on p. 50, n. 1, *supra*, p. 893), and ACJ's counsel answered, "The only question in my mind as to the record * * * is whether you have in your full figures for accrued depreciation" (*id.*, p. 968).

[1]R. 224. [2]R. 1061-62. [3]R. 1063.

the capitalization urged by Commissioner Miller of $120,000,000 in order to "give the present stockholders a chance to participate in the future profits of the reorganized company" by giving them some "no-par-value common stock" which "may have little or no market value,"[1] the Commission did, in fact, give substantial consideration and weight to these elements of physical value.

That it gave substantial consideration to such elements is shown by the many references to them in the Tentative Report of the Bureau of Finance and the three Reports of the Commission.[2]

That it also gave substantial weight to the elements of physical value becomes evident upon the consideration of "the earning power of the property, past, present, and prospective" and its inadequacy, taken alone, to support the capitalization contemplated by the Commission Plan.

(ii) *Earning Power.*

As already noted (p. 54, *supra*), the capitalization provided by the Commission Plan requires annual earnings of approximately $3,650,000 for coverage of charges through dividends on Preferred Stock, and a total of approximately $4,600,000 to achieve earnings of $3 per share on the new Common Stock after all prior charges.

Sustained earnings to create a continuous record of actual payment of dividends of at least $3 per share on the Common Stock must be realized if the value of that stock is ever to approach the sum of $57 per share. That is the figure at which it was allotted to the First Mortgage Bondholders under the Commission Plan and represents the value which it must attain if the value of the securities allotted to the First Mortgage Bondholders is ever to make

[1] R. 283-4. [2] R. 123-4, 144, 203, 224, 313-4.

them whole by equalling the amount of their claims as of January 1, 1939.

$4,600,000 in annual earnings is thus the minimum annual earnings level which the Debtor's properties must attain and continuously maintain before the new securities allotted to the senior First Mortgage Bonds under the Commission Plan can give to the First Mortgage Bondholders, in any sense of those terms, full recognition of their absolute priorities and full compensation for their surrendered rights.

The Debtor's earnings record, set forth above at page 7, gives little basis for hope of the maintenance of any such level.

The relationship of this earnings record to the capital structure contemplated by the Commission Plan is strikingly shown by the graph inserted opposite this page. The earnings of the Debtor's properties available for interest, adjusted as stated above at page 6, have only once in the last twenty years (1926) reached the amount continuously necessary to "make whole" the First Mortgage Bondholders; and only in two additional years (1925 and 1928) have they even approximated that amount. And this, the record indicates, was at the expense of substantial undermaintenance,[1] for which no deduction has been made in the adjusted earnings as stated on page 7 and in the graph.

It will further be noted that in only two additional years (1929 and 1941) were the Preferred dividends substantially fully covered and in only six additional years (1922, 1923, 1924, 1927, 1930 and 1940), have there been any earnings available for *any part* of the dividends on the new Preferred Stock.

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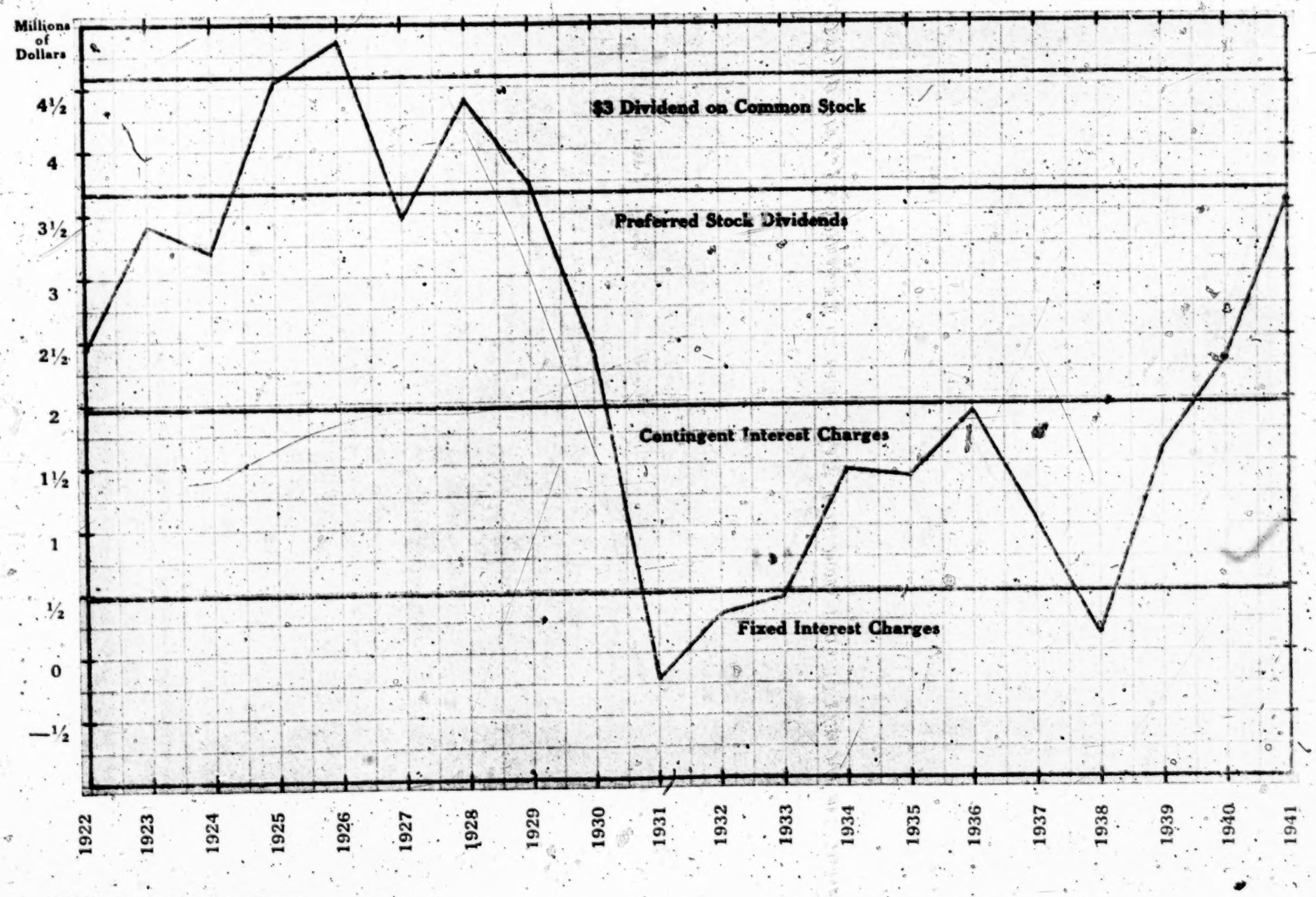
[1] R. 1052.

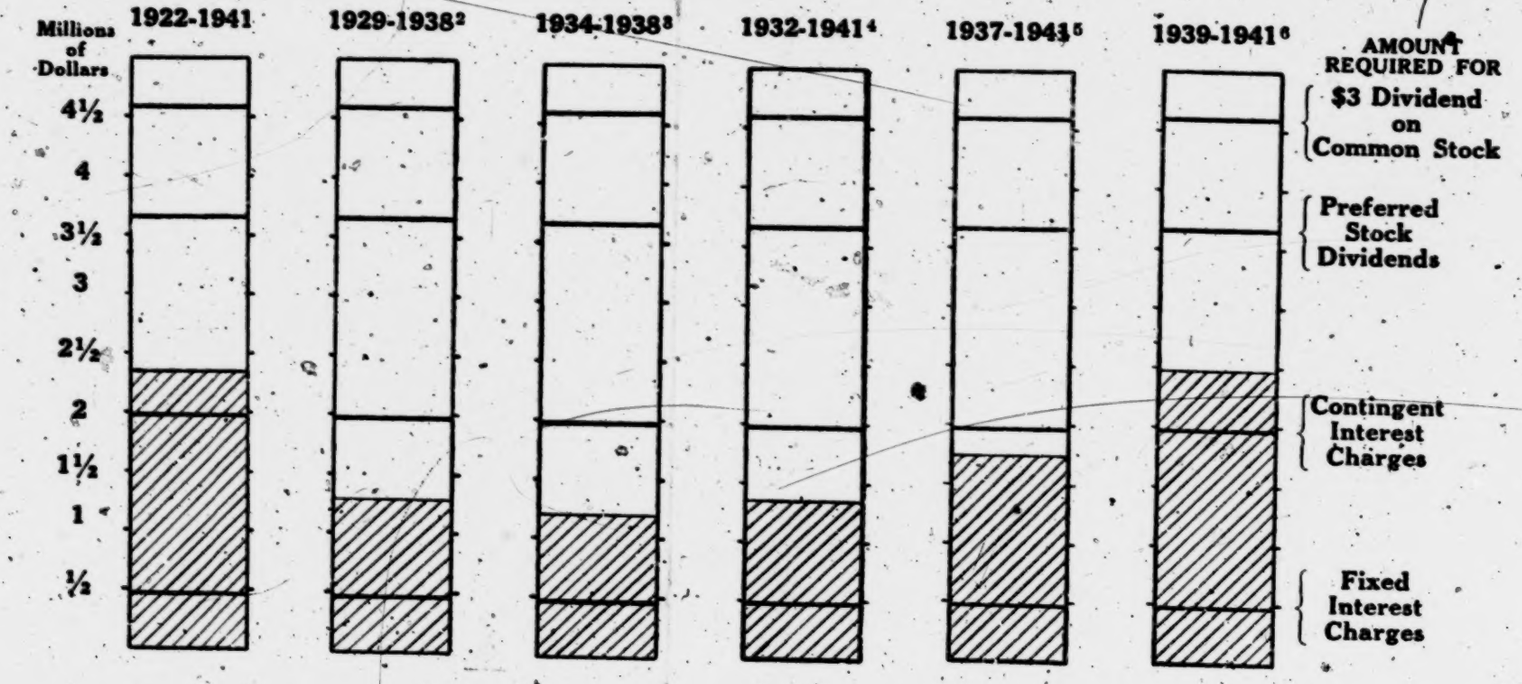
APPLICATION OF DEBTOR'S EARNINGS[1] TO CAPITALIZATION UNDER COMMISSION PLAN



[1] Adjusted as stated on page 6, *supra*.

AVERAGE ANNUAL EARNINGS[1] AS APPLIED TO CAPITALIZATION UNDER COMMISSION PLAN

[The diagonally hatched portions of the blocks represent earnings; the blank portions represent deficits.]



[1]Adjusted as stated on page 6, *supra*.
[2]10 years preceding Commission action.
[3]5 years preceding Commission action.
[4]The most recent 10 years.
[5]The most recent 5 years.
[6]The 3 years since the effective date of the Commission Plan.

In four of the twenty years (1931, 1932, 1933 and 1938) the earnings were inadequate to cover even fixed charges under the Commission Plan, and in five additional years (1934, 1935, 1936, 1937 and 1939) they were inadequate to cover contingent debt charges.

The inadequacy of the Debtor's earnings to support any larger capital structure than that contemplated by the Commission Plan is further evidenced by the graphs inserted opposite this page showing the application of average adjusted earnings for the various indicated periods to the amounts required to service the capitalization under the Commission Plan.[1]

The averages for none of those periods, except for the entire twenty years and for the three years since January 1, 1939, have been adequate to cover even full contingent debt charges under the Commission Plan. Were the earnings for the full twenty years to be further adjusted to deduct the large amount of under-maintenance which accrued prior to 1927, it is doubtful that the average for the twenty year period would cover the full contingent debt charges.

In none of the periods have the average earnings been sufficient fully to cover the requirements for Preferred Stock dividends, let alone anything toward Common Stock dividends.

The liberality to the junior interests of the capitalization proposed by the Commission Plan, as well as the optimism with which the future must be regarded, in the light of past

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[1]Average earnings for the various indicated periods on the graph are as follows:

1922-1941	$2,320,878	1932-1941	$1,420,513
1929-1938	$1,261,539	1937-1941	$1,754,410
1934-1938	$1,195,528	1939-1941	$2,489,737

earnings, to justify the maximum value for reorganization purposes found by the Commission, is evidenced by the following illustrative tabulations. That maximum value, it will be remembered, is $84,027,559.[1]

To produce that amount average earnings must be capitalized:

for 1922 to 1941 at the rate of 2.76%
for 1929 to 1938 at the rate of 1.50%
for 1934 to 1938 at the rate of 1.42%
for 1932 to 1941 at the rate of 1.69%
for 1937 to 1941 at the rate of 2.09%
for 1939 to 1941 at the rate of 2.96%

Especially striking is the fact that the earnings for the years 1939 to 1941, to which the Commission Plan will actually be applied if it is consummated, must be capitalized at the rate of 2.96% to produce the Commission-found maximum "value for reorganization purposes" of $84,027,559.

Before the unsecured debt and stock of the Debtor held by WP Corp. can have any "value for reorganization purposes" an aggregate of such value for the Debtor's properties must be found, not of $84,027,559, but in excess of $87,922,143.

The foregoing computations put beyond any possibility of reasonable dispute the soundness of the Commission's

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[1]The aggregate amount of the par value securities plus the price of $57 per share for the Common Stock, required to "make whole" the First Mortgage Bondholders and the RFC Notes.

finding that the unsecured debt and the stock of the Debtor "have no value."

5. The effect of War Boom Earnings

As the European war began to affect the national economy after the Commission had certified its Plan to the District Court, the Debtor's earnings began a marked upward trend. 1940 earnings were substantially twice those for 1939. 1941 earnings showed a further large increase. In the first six months of 1942 the Debtor's total consolidated system operating revenues were $16,235,602, as compared with $10,111,000 for the corresponding six months of 1941 and, for the same periods, its income available for income and excess profits taxes and interest was $4,108,290 in 1942 as compared with $1,081,727 in 1941. We believe that there is no question but that those increases were the result of a combination of accelerating "defense" and war activities, the shortage of shipping tonnage and the practical cessation of transportation between the East Coast and the West Coast through the Panama Canal. Those increases in earnings have kept close pace with the change-over to the war time economy.

The junior interests urged, before both the District Court and the Circuit Court of Appeals, that increasing earnings of the Debtor made the Commission Plan obsolete and required a new "valuation" which, they argued, would evidence a "value" for the Debtor's unsecured debt and its stock. As the increasing trend of the Debtor's earnings has accelerated rather than diminished since the argument before the Circuit Court of Appeals, the same issue will be presented to this Court.

That issue, the Committee believes, should be faced squarely by this Court.[1] If war boom earnings of the nature experienced by the Debtor (and in varying degrees by most other railroads) are to require a reconsideration of "prospective earning power" of properties in Section 77 proceedings, in the face of such records of "past earnings" as that of the Debtor, the parties to all Section 77 proceedings, as well as the Commission, should know it at the earliest possible moment.

Before consideration of the legal effect of war inflated earnings, it should be noted that the reported amounts may be disputed on two counts.

Those earnings, as reported, are not mathematically comparable with the prior record of the Debtor's earnings. No account is taken in the available 1942 figures, as set forth above, of the increasingly heavy Federal income and excess profits taxes necessarily resulting from the very facts which give rise to the increased revenues. No accurate determination can be made at this time of the Federal taxes properly to be deducted from 1942 earnings on the basis of the Commission's capitalization, in part because the relevant tax legislation has not yet been enacted. An example of the material nature of such tax liability is the fact that, on the basis of the income available for such taxes and interest for the first six months of 1942 ($4,108,290), after deducting six months interest charges under the Commission Plan and applying the tax rates contained in the proposed Revenue

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[1] Judicial notice may be taken of such increasing earnings. See *McCart* v. *Indianapolis Water Co.*, 302 U. S. 419 (1938); *In re Chicago & North Western Ry.*, 126 F. (2d) 351, 364 (C. C. A. 7th, 1942).

Act of 1942 as passed by the House of Representatives and as approved by the Senate Committee at the date of this brief, the Federal income tax payable with respect to those earnings would be approximately $1,500,000.[1] Thus an apparent war boom figure of $4,108,290 is reduced, with respect to income available for both interest and dividends, to about $2,600,000. Even this figure is before deducting for any excess profits tax which may be imposed upon the reorganized Western Pacific at the current earnings level, depending upon tax legislation as finally enacted.

Also, no account has been taken of the fact that the Debtor's properties are all being put to extraordinary wear and tear in the production of these increased earnings, and that shortages and priorities of both labor and materials are preventing expenditures for maintenance of way, structure and equipment commensurate with the increased use.[2]

The question here is whether the Debtor's war time boom earnings, clearly temporary (and also subject to the indeterminate tax and deferred maintenance deductions

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[1]Non-recurring losses or other deductions might well reduce the income tax in one year, but they are not material in the search for indicia of "prospective earnings" over a period. The above figure of $1,500,000 is computed without allowing any credit for any excess profits taxes payable. While the imposition of an excess profits tax would decrease the income tax payable, it would increase the over-all income and excess profits tax liability of the Debtor.

[2]R. V. Fletcher, Vice President of the Association of American Railroads, recently pointed out that due to shortages of labor and materials, the railroads "are going to come out of this war * * * with their tracks more or less run down and with their equipment in a shaky condition." Hearings before the Senate Committee on Finance on H. R. 7378 (77th Cong., 2nd Sess.) at p. 766.

indicated), are sufficiently reliable evidence of the Debtor's "prospective earning power" to justify the abandonment of the findings of the Commission and the District Court that the Debtor's unsecured debt and stock "have no value"—findings based on the record of the past twenty years of the Debtor's operations and earnings and all other relevant factors with respect to the Debtor's "prospective earnings."

The Committee does not believe that a railroad reorganization having as its objective the creation of a sound financial structure which can continue unscathed through the probable depressions of the post-war period and the inevitable ups and downs of railroad earnings can be predicated on the hypothesis of indefinite continuance of a war economy, carrying with it the cessation of water, truck and air competition. As Commissioner Eastman in an address before the National Association of Mutual Savings Banks at Philadelphia on May 7, 1941, said:

> "Let me suggest, however, that those who regard these present earnings as evidence of the unsoundness of our reorganization plans may well give heed to the source from which these earnings spring and to the future conditions which are likely to flow from this same source. * * * All this in the end means burden and sacrifice for all concerned. * * *"

Since the beginning of 1941 the Commission has approved plans for the reorganization of nine railroads.[1] In

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[1] *Fort Dodge, Des Moines & Southern R. R.*, 244 I. C. C. 625 (1941); *New York, New Haven & Hartford R. R.*, 244 I. C. C. 239 (1941); *Alabama, Tennessee & Northern R. R.*, 247 I. C. C. 453 (1941); *Chicago, Rock Island & Pacific Ry.*, 247 I. C. C. 533 (1941), 249 I. C. C. 297 (1941); *St. Louis Southwestern*

none of those plans has the Commission regarded war boom earnings as furnishing any controlling or reliable indicia of the railroad's prospective earning power. In one of its latest decisions the Commission summarized its position in this respect:

> "In the report of April 6, 1942, Division 4 recognized the fact that 1941 earnings were influenced by the extraordinary conditions existing as the result of the war and in the report stated fully all considerations leading to its conclusions as to justifiable amounts of capitalization and of new general mortgage bonds. Under present conditions, the fact that the year 1942 gives promise of producing even larger earnings than 1941 affords too uncertain and precarious a basis to justify the increases sought."[1]

Two months ago the Circuit Court of Appeals for the Sixth Circuit likewise squarely rejected the argument that 1940 and 1941 earnings of a railroad, representing abnormal increases attributable to the prosecution of the war effort, were any support for a Debtor's objection that the Commission's valuation of the railroad was too low.[2]

Ry., 249 I. C. C. 5 (1941), 252 I. C. C. 325 (1942); *Fonda, Johnstown & Gloversville R. R.*, 249 I. C. C. 455 (1941); *Minneapolis, St. Paul & Sault Ste. Marie Ry.*, (Finance Docket No. 11897, March 17 and June 17, 1942, not yet reported); *Denver & Rio Grande Western R. R.* (Finance Docket No. 11002, July 13, 1942, not yet reported); *Florida East Coast Ry.* (Finance Docket No. 13170, April 6 and August 10, 1942, not yet reported).

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[1] *Florida East Coast Ry.* (Finance Docket No. 13170, August 10, 1942, not yet reported).

[2] *Akron, Canton & Youngstown Ry. Co.* v. *Hagenbuch*, 128 F. (2d) 932 (C. C. A. 6th, 1942).

With reference to such war boom earnings the Court stated:

> "It is conceded that these abnormal increases [earnings from January 1, 1940, to October 31, 1941] are solely attributable to the prosecution of the war effort of the Government. These abnormalities are not proper tests by which to measure the Commission's determination of the somewhat imponderable prospective earnings in 1937. Subsequent earnings due to unforseeable circumstances may not be used to check the correctness of prospective earnings as determined by the Commission under the Act. Naturally such earnings could not have entered into any purchaser's estimate of value." (at p. 939)

A similar attempt to increase the total capitalization approved by the Securities and Exchange Commission in the reorganization of a utility was rejected by a District Court which pointed out that such booms are generally followed by periods of depression.[1]

Apparently the investing public does not regard the present abnormally high level of railroad earnings as any criterion of the long-range value of railroad securities. That opinion is shown by the substantial discounts at which the securities constituting the entire capital structures of such solvent roads as the New York Central, Northern Pacific, Southern Pacific and Southern Railway are selling (see page 43, *supra*) and, again, by the prices at which the senior obligations of recently reorganized

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[1] *In re Utilities Power & Light Corp.*, 29 F. Supp. 763, 770 (N. D. Ill., 1939).

railroads are selling. Examples of the latter include the market price of 64 for the First Mortgage Bonds of the new Chicago Great Western, of 90¼ for those of the new Erie and of 78 for those of the new Wabash.[1] The extreme to which the investing public is discounting war boom earnings is further demonstrated by the fact that stocks of many solvent railroads are selling at less per share than their estimated 1942 earnings per share after taxes.[2]

Finally, it is relevant to compare even the war earnings of Western Pacific with the capitalization provided by the Commission Plan. Under that Plan the new Western Pacific will need to have *continuously* available for interest and dividends, after proper deductions for Federal income and excess profits taxes and adequate maintenance, earnings of at least $4,600,000 per annum. That level of earnings, as we have shown above, is the necessary minimum available for dividend payments to give the new company's no par value common stock the value of $57 a share which would in any sense approximately "make whole" the present First Mortgage Bondholders. Nothing has been shown to date to suggest any likelihood of that figure being continuously maintained, much less surpassed

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[1] The prices given are the July 31, 1942, prices, at a time when the great increases in war time earnings were evident. The September 1, 1942 prices for the same issues, following a recent increase in market prices of railroad securities, were Chicago Great Western 66, Erie 91, and Wabash 80¼.

[2] For example, Standard Statistics estimated on August 4, 1942, that the 1942 earnings after taxes of Southern Railway will be $17.40 on its Common Stock, which was then selling at 15. Similarly, estimated earnings of Southern Pacific are $14.35 per share as compared with a market value of 13⅝, and earnings of $6.05 are predicted for Kansas City Southern stock selling at 4.

The only effect that Western war boom earnings can have on the Commission Plan is to give its optimistic capital structure some degree of substance. This case involves no change of facts justifying a reconsideration of the previous determinations by the Commission and the District Court that the unsecured debt and stock of the Debtor "have no value."

6. The Absence of a Formal Finding of a Dollars and Cents Value of the Debtor's Properties as an Entirety

It will be the purpose to discuss here only the "findings" necessary to sustain exclusions of classes of creditors and stockholders. The problem of the "findings" necessary for allocations of securities among participating classes will be discussed under Point II.

Pursuant to Section 77, the Commission has formulated plans of reorganization for sixteen Class I railroads.[1]

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[1] *Akron, Canton & Youngstown Ry.*, 228 I. C. C. 645 (1938); *Chicago & Eastern Illinois Ry.*, 230 I. C. C. 199 (1938), 230 I. C. C. 571 (1939); *Chicago Great Western R. R.*, 228 I. C. C. 585 (1938), 233 I. C. C. 63 (1939); *Spokane International Ry.*, 228 I. C. C. 387 (1938), 233 I. C. C. 157 (1939); *Western Pacific R. R.*, 230 I. C. C. 61 (1938), 233 I. C. C. 409 (1939), 236 I. C. C. 1 (1939); *Chicago & North Western Ry.*, 236 I. C. C. 575 (1939), 239 I. C. C. 613 (1940); *Missouri Pacific R. R.*, 239 I. C. C. 7 (1940), 240 I. C. C. 15 (1940); *Chicago, Milwaukee, St. Paul & Pacific R. R.*, 239 I. C. C. 485 (1940), 240 I. C. C. 257 (1940); *Erie R. R.*, 239 I. C. C. 653 (1940), 240 I. C. C. 469 (1940); *St. Louis-San Francisco Ry.*, 240 I. C. C. 383 (1940), 242 I. C. C. 523 (1940); *New York, New*

Of these plans four have been consummated,[1] the remainder being at various stages of the procedure prescribed by Section 77. In thirteen of these plans[2] classes of stockholders have been excluded from participation, and in five, classes of creditors have also been excluded.[3] In all these plans the findings of the Commission upon which the exclusion of stockholders and creditors (as well as the allocations of new securities) were based were substantially identical in form with those in the *Western Pacific* case and were supported by substantially similar "valuation data."

Attacks by the excluded junior classes upon the sufficiency of such findings have been overruled by every Dis-

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Haven & Hartford R. R., 239 I. C. C. 337 (1940), 244 I. C. C. 239 (1941); *Chicago, Rock Island & Pacific Ry.*, 242 I. C. C. 298 (1940), 247 I. C. C. 533 (1941), 249 I. C. C. 297 (1941); *St. Louis Southwestern Ry.*, 249 I. C. C. 5 (1941), 252 I. C. C. 325 (1942); *Minneapolis, St. Paul & Sault Ste. Marie Ry.*, (Finance Docket No. 11897, March 17 and June 17, 1942, not yet reported); *Denver & Rio Grande Western R. R.*, 233 I. C. C. 515 (1939), 239 I. C. C. 583 (1940), (Finance Docket No. 11002, July 13, 1942, not yet reported); *Florida East Coast Ry.* (Finance Docket No. 13170, April 6 and August 10, 1942, not yet reported).

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[1]Chicago & Eastern Illinois Ry.; Chicago Great Western R. R.; Erie R. R.; and Spokane International Ry.

[2]Chicago & Eastern Illinois Ry.; Chicago Great Western R. R.; Chicago, Milwaukee, St. Paul & Pacific R. R.; Chicago & North Western Ry.; Chicago, Rock Island & Pacific Ry.; Denver & Rio Grande Western R. R.; Minneapolis, St. Paul & Sault Ste. Marie Ry.; Missouri Pacific R. R.; New York, New Haven & Hartford R. R.; St. Louis-San Francisco Ry.; St. Louis Southwestern Ry.; Spokane International Ry.; and Western Pacific R. R.

[3]Denver & Rio Grande Western R. R.; Minneapolis, St. Paul & Sault Ste. Marie Ry.; St. Louis-San Francisco Ry.; Spokane International Ry.; and Western Pacific R. R.

trict Court before which those plans have come, and the exclusions sustained.[1]

The Securities and Exchange Commission, in dealing with bankruptcy reorganizations of public utility holding companies under Section 11 (f) of the Public Utility Holding Company Act [15 U. S. C. §79k (f)], performing functions similar to those performed by the Interstate Commerce Commission under Section 77,[2] has predicated exclusions of classes upon similar findings and valuation data.[3]

The effectiveness of findings of "no value," when supported by valuation data similar to that in the present record, had thus become, in practice, established law prior to the decision of the Circuit Court of Appeals for the Ninth Circuit here under review. That decision came as a shock to the "reorganization bar"[4] greater even than that experienced upon the decisions in the *Monon* case[5] and the *Boyd* case.[6] Notwithstanding that the Circuit Court of Appeals for the Seventh Circuit somewhat equivocally con-

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[1] *In re Chicago & North Western Ry.*, 35 F. Supp. 230, 245 (N. D. Ill. 1940); *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 36 F. Supp. 193, 203 (N. D. Ill. 1940); *In re Missouri Pacific R. R.*, 39 F. Supp. 436, 444 (E. D. Mo. 1941); *In re St. Louis-San Francisco Ry.* (not yet reported, E. D. Mo. 1942).

[2] *In the Matter of Peoples Light and Power Co.*, 2 S. E. C. 829, 847 (1937).

[3] *In the Matter of West Ohio Gas Co.*, 3 S. E. C. 1014 (1938); *In the Matter of Ulen & Co.*, S. E. C. Corp. Reorg. Rel. No. 43 (June 21, 1941).

[4] See Edward W. Bourne (1942) *Findings of "Value" in Railroad Reorganization*, 51 Yale L. J. 1057.

[5] *Louisville Trust Co.* v. *Louisville, New Albany & Chicago Ry.*, 174 U. S. 674 (1899); see statement of Adrian H. Joline quoted at p. 197 of Some Legal Phases of Corporate Financing, Reorganization and Regulation (1917).

[6] See Cravath, *The Reorganization of Corporations* (1917) Some Legal Phases of Corporate Financing, Reorganization and Regulation 153.

curred with that for Ninth Circuit as to the necessity of more specific valuation findings for purposes of distribution, the Seventh Circuit refused to go along with the Ninth Circuit on the point here under discussion; it twice sustained the effectiveness of findings of "no value" for the purpose of exclusion from participation.[1]

It is submitted that nothing in Section 77 or in this Court's opinion in the *Consolidated Rock Products* case, which the Court below thought compelled its decision, lends any support to that decision.

Section 77 (d) requires that "the Commission shall render a report and order in which it shall approve a plan * * * that will in its opinion meet with the requirements of subsections (b) and (e) * * * and will be compatible with the public interest; * * * In such report the Commission shall *state fully the reasons for its conclusions.*"

Certainly this provision affords no possible basis for a requirement of formal findings of fact, and certainly no one can contend that in the voluminous reports and orders of the Commission in this case the Commission has failed to "state fully the reasons for its conclusions."

The only references in Section 77 to a "finding" by the Commission or by the District Court include, as a basis of exclusion, findings in exactly the words of the findings in the present case. Subsection (e) provides that the

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[1] *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 124 F. (2d) 754 (C. C. A. 7th, 1941); *In re Chicago & North Western Ry.*, 126 F. (2d) 351 (C. C. A. 7th, 1942). In its supplemental opinion in the former case (unreported, see Record before this Court, p. 2335, in Docket Nos. 11-19), the Circuit Court held

> "* * * that the finding of the I. C. C. as to absence of value of old common and preferred stock, is specific, definite and certain, and fully meets the rule which requires finding on values of assets."

> "submission [of a plan] to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding * * * that at the time of the finding the equity of such class of stockholders has no value,"

and that

> "submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding * * * that at the time of the finding the interests of such class of creditors have no value * * *."

That provision of subsection (e) upon which the Court below relied does not require the Commission to determine and certify "value" in detail of exact dollars and cents in every case. It provides for a determination and certification of value only "if it shall be necessary * * * for any purpose under this section * * *."

Nor is there anything in the Interstate Commerce Act which requires the Commission to make such formal findings of detailed values as the Court below would require. Section 14 of that statute provides:

> "(1) Whenever an investigation shall be made by said commission, it shall be its duty to make a report in writing in respect thereto, which shall state the conclusions of the commission, together with its decision, order, or requirement in the premises; and in case damages are awarded such report shall include the findings of fact on which the award is made."

[1]This was pointed out in the opinions of Barnes, J., in *In re Chicago & North Western Ry.*, 35 F. Supp. 230, 244 (N. D. Ill. 1940); and of Igoe, J., in *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 36 F. Supp. 193, 203 (N. D. Ill. 1940).

In the light of Section 14 this Court has held that "There are no formal requirements for the findings to be made by the Commission in this type of case * * *" [a removal of rate discrimination].[1] This being the only provision of the Interstate Commerce Act providing for express "findings of fact," it is clear that the only situation in which the Commission's report must contain such findings is a case where damages are awarded.

Nor is there any requirement of such findings under the Constitution. The objecting junior interests relied below upon this Court's opinions that the Commission must find the facts necessary to exist before the Commission has jurisdiction to issue the order in question.[2] Obviously there is no "jurisdictional" distinction between a finding, supported by adequate valuation data, that the interest of a class of creditors or stockholders "has no value" and a finding giving the mathematical demonstration of that conclusion by finding a dollars and cents value for the property of a debtor in an amount less than the amount of the claims senior to those found to "have no value."

Least of all does the opinion of this Court in the *Consolidated Rock Products* case support the conclusions of the Court below. To be sure, that opinion contains the phrase which became the theme song of the objectors below and was echoed in the opinion of the Circuit Court of Appeals—

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[1] *United States* v. *Louisiana*, 290 U. S. 70, 80 (1933). See *Manufacturers Ry.* v. *United States*, 246 U. S. 457, 489-90 (1918).

[2] *Florida* v. *United States*, 282 U. S. 194 (1931); *United States* v. *Baltimore & Ohio R. R.*, 293 U. S. 454 (1935); *United States* v. *Chicago, Milwaukee, St. Paul & Pacific Ry.*, 294 U. S. 499 (1935).

"absent the requisite valuation data"[1] and also the statement almost equally stressed in the arguments below— "* * * no adequate finding was made as to the value of the assets * * *. * * * a determination of that value must be made * * *."[2] The factual situation in which those expressions were used in the *Consolidated Rock Products* case, however, was one in which there was substantially no "valuation data" and no attempt to determine, upon any basis, relative values as between different properties securing two different bond issues. It requires extreme distortion[3] of the quoted words of the opinion to convert them into a rejection of the sufficiency of the "valuation data" and the "findings" actually made in the *Western Pacific* case.

The whole context of the opinion in the *Consolidated Rock Products* case, as well as its factual background, evidences that the writer of the opinion had no intention of over-riding the practice followed by the Securities and Exchange Commission at a time when he was a member of that Commission. In *In the Matter of West Ohio Gas Co.*, 3 S. E. C. 1014, at 1026-27 (1938), the SEC said:

> "In passing upon the fairness of this plan it is not necessary for us to determine the exact value of the property or the amount at which its value shall be recorded on the books of the reorganized company. The evidence which has been submitted to us points to the conclusion that the property has very little, if any, value in excess of the aggregate amount ($1,755,977) of the claims of the bondholders."

The basic fact which determines whether or not any class of existing securityholders *must* be excluded from par-

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[1] 312 U. S. 510, 520 (1941). [2] *Id.*, at 524.

[3] Similar to that experienced by the term "relative priorities." See p. 29, *supra*, n. 2.

ticipation in a reorganization is not the precise dollars and cents value of the property but the ultimate fact that the interest or equity of that class "has no value." Not only is this evidenced by the express language of Section 77 (e), which contemplates findings of "no value," but it is equally established by the decisions of this Court.[1] If *absence* of value is certified by the Commission to the court, as it was here, and is established by adequate valuation data, as it was here, it is wholly unimportant to know by how great a margin the interest or equity having no value falls short of having value.

The recognized impossibility of determining an exact dollars and cents value for a great railroad system, as of any given date, argues strongly against the existence of any such requirement under Section 77 and is compelling proof that the Congress did not intend to prescribe any such futile procedure. As this Court has stated:

> "The very notion of a 'full cash value' for a railroad is in many respects artificial. * * * Whatever may be the pretenses of exactitude in determining such a 'value,' to claim for it 'scientific' validity, is to employ the term in its loosest sense."[2]

But even if some type of dollars and cents value were required to be found, it is submitted that the findings made by the Commission in this case, amplified and affirmed by the opinion of the District Judge, would fully satisfy any such requirement.

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[1] *In re* 620 *Church Street Building Corp.*, 299 U. S. 24, 27 (1936).

[2] *Nashville, Chattanooga & St. Louis Ry.* v. *Browning*, 310 U. S. 362, 370 (1940). See also *Rowley* v. *Chicago & North Western Ry.*, 293 U. S. 102, 109 (1934).

As has been pointed out above,[1] the Commission not only found that the unsecured debt and stock of the Debtor "have no value," but, having found the aggregate amount and character of the capitalization permissible under the provisions of Section 77, *i.e.*, the maximum aggregate "reorganization value," it also found that the entire permitted capitalization was "inadequate in value to satisfy" the secured claims.[2]

It requires but a simple mathematical process of adding together five classes of claims, the amounts of which are stated in dollars and cents in the Commission's Report and Order dated June 21, 1939,[3] to develop the fact that the claims senior to the unsecured debt and stock of the Debtor aggregate $87,922,142.75. The Commission therefore found, in substance, that the reorganization value of the Debtor's properties (and of all the new capitalization) was *less than* $87,922,142.

Similarly, it requires only the mathematical process of adding the par value securities provided for by the Commission Plan, and which it distributed at their par value, to the sum obtained by multiplying 319,441 by $57, the price at which those shares of Common Stock was allotted to the First Mortgage Bondholders to "make whole" their claims, to establish the *maximum* "reorganization value" attributed by the Commission to the Debtor's properties as represented by the entire new capitalization. That amount is $84,027,559.

The Commission therefore *did* find in the *Western Pacific* case, in every substantive sense, the only kind of "value" which was relevant to the exclusion of the Debtor's

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[1]See pp. 17-18, *supra*. [2]R. 269. [3]R. 316-7, 390-2.

unsecured debt and stock. It did find, in substance, that the "reorganization value" of the Debtor's properties fell short by at least $3,894,583.75 of providing any participation for that unsecured debt and stock.

The complete lack of realism in the decision of the Court below upon this point is evidenced by what the Commission has tried to do to bring its more recent reports and orders into colorable compliance with that decision. In those cases the Commission, after making exactly the same type of findings with respect to earning power and permitted capitalization that were made in the *Western Pacific* case, has added a final finding of which that in the *Denver & Rio Grande Western* case[1] is typical:

> "Considering the entire record, and taking into account the elements of value of the properties involved, their past and present earnings and prospects for future earnings, as well as other pertinent factors, we conclude and find *that the value of the properties for the purposes of this proceeding* is $154,521,612, and that the total capitalization upon consummation of the plan should not exceed approximately that amount."

It is submitted that the addition of the italicized words, which are not to be found *in haec verbes* in the Commission's *Western Pacific* Report, would add absolutely nothing of substance for the information either of the court or of the securityholders beyond what the Commission provided in the findings summarized at pages 14 to 18, *supra*, and the voluminous "valuation data" discussed by the Commission in "stating fully the reasons for its conclusions."

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[1]Finance Docket No. 11002 (July 13, 1942), not yet reported.

7. Conclusion

The valuation data contained in this record strongly supports the conclusion that there is no reasonable probability that the earning power of the Debtor's properties will be sufficient to provide, over any reasonable period, full service of the present contractual income rights of the secured creditors or to provide ultimate cash recovery of the full claims of those creditors. That valuation data wholly fails to indicate the *presence* of earning power for the Debtor's unsecured debt and stock. Hence the exclusion of that debt and stock from participation in the reorganization does not violate any rights of their holder, WP Corp.

Indeed, the demonstrated *absence* of such reasonable probability of earning power compels exclusion of the unsecured debt and stock of the Debtor if the rights of the secured creditors are not to be violated.

The findings of the Commission that "the equity of the existing stock has no value" and that "the claims of the unsecured creditors have no value" are sufficient to support that exclusion.

No factual change has occurred which requires reconsideration of those findings and conclusions.

II

THE DETERMINATIONS BY THE COMMISSION AND THE DISTRICT COURT OF THE EQUITABLE EQUIVALENT OF THE DEBTOR'S ASSETS AVAILABLE FOR THE SATISFACTION OF EACH CLASS OF PARTICIPATING CLAIMS, IN TERMS OF THE VARIOUS NEW SECURITIES, AS SUPPORTED BY THE VALUATION DATA AND THE OTHER FINDINGS IN THE RECORD, ARE SUFFICIENT TO SUSTAIN THE ALLOCATIONS CONTAINED IN THE COMMISSION PLAN.

1. The Purpose of Reorganization

The purpose of a reorganization under Section 77 is not liquidation by the payment either of cash or of cash equivalents in new securities. Its purpose is rather to insure to each class of old securities admitted to participation (*i.e.*, those which have any interest of "value" in the property) its "equitable equivalent of the debtor's assets available for the satisfaction" of its claim on a going concern basis. That "equitable equivalent" must be found, not in terms of dollars and cents, but in terms of the new securities to be issued in the reorganization, *i.e.*, new securities which will return to each existing class its "equitable equivalent," whatever may be the level to which the earnings of the reorganized venture may fall or rise.

To that end the relative priorities[1] of the existing classes in the earning power and assets of the venture must be fully recognized.

So far as feasibility and the public interest permit, such recognition should be given "qualitatively," *i.e.*, by

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[1]These words are used in this Point II, not in the sense in which they are used in the opinion in the *Consolidated Rock Products* case, but to denote the relative positions of different classes in respect of their *full* amounts. See p. 29, *supra*, n. 2.

allocation to the participating old securities new securities of relative rank in their claims to income and assets comparable to the relative rank of the old securities. Equitable compensation for rights which the exigencies of reorganization compel the senior securities to surrender should also, so far as permitted by feasibility and the public interest, be incorporated in the new securities. Examples of such compensating provisions are conversion rights and participation rights which will tend to make up in periods of high earnings for income lost in periods of low earnings.

In so far as feasibility and the public interest prevent such relative priorities being "made whole" "qualitatively," they must be made whole, and equitable compensation for surrendered rights must be made, "quantitatively," *i.e.*, by giving to the old senior securities new securities of the same classes as those given existing junior securityholders but upon terms sufficiently more favorable than those given the junior securityholders.

The solution of these problems of allocation in a complicated railroad reorganization does not require, or even admit of, a "rigid formula." It necessitates "practical adjustments" based upon experienced judgment.

2. The Practice of the Commission

By hypothesis the problem of distributing a reorganized capital structure among old securityholders admitted to participation is not reached until the over-all "reorganization value" of the properties and the permissible aggregate capitalization, and the classification thereof, have been determined. By hypothesis, therefore, the interests of the creditors or stockholders excluded are without such value to the extent of their exclusion. By the same hypothesis the

participating securities are covered by "reorganization value," supported by "prospective earning power," to the full amount of the "reorganization value" thus determined.

But as there are different degrees of probability of prospective earning power, the Commission has classified aggregate capitalization into classes of new securities representing claims in a heirarchy of rank within the earning power, as well as against the assets, of the reorganized venture. Generally it has adopted the four broad classifications of fixed charge obligations, contingent charge obligations, preferred stock, and common stock.

It has also sought to "tailor" the new securities to the requirements of a "fair and equitable" distribution, so designing the new securities as to facilitate giving to each participating old class its "equitable equivalent of the debtor's assets available for the satisfaction" of its claim.

In almost every complicated railroad reorganization the Commission has had the problem of allocation before it in two aspects: (a) allocation as between two classes of creditors having successive liens upon the same property, and (b) allocation as between two classes of creditors having liens of the same rank upon different properties. In the *Western Pacific* case (as we shall see in our subsequent discussion of the allocations made in the Commission Plan[1]) the Commission had to determine allocations between the First Mortgage Bonds and the Refunding Bonds which involved a combination of both these aspects.

While this Court has held that mere observance of the relative priorities[2] was not sufficient to validate a reor-

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[1]Page 96, *infra*.

[2]See p. 29, *supra*, n. 2, for a statement of the very limited sense in which that phrase was appropriate upon the facts of the *Los Angeles Lumber* and *Consolidated Rock Products* cases.

ganization plan in which stockholders whose equity had no value had been admitted to participation, this Court has never indicated that a plan would be valid which did not fully recognize the relative priorities of the existing classes in the earning power of the venture in such manner as might be practicable under all the circumstances. Indeed, the whole trend of the Court's decisions is to the contrary.[1]

Accordingly, as between creditors having liens of successive rank upon the same assets (whether the more junior claim was admitted to full participation or, as in the case of the Western Pacific Refunding Bonds, only to partial participation), the Commission has consistently followed the practice above urged. It has sought, so far as possible from the standpoint of feasibility and public interest, to preserve the seniority, as against both earnings and assets, of the new securities given to the old senior securityholders. It has endeavored to include in such new senior securities elements compensatory, to the extent practicable, for the surrender of such rights as early maturity, fixed interest, or debt position. In other words, so far as feasibility and public interest permitted, the seniority of the old securities has been given "qualitative" recognition in the new securities.

Where such qualitative recognition has been impossible, the Commission has sought to give reasonably compensating "quantitative" recognition. That is to say, it has awarded to the old securities, to the extent necessary, new junior securities of the same class allotted to old securityholders having a lien upon the same assets but of junior

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[1] *Northern Pacific Ry.* v *Boyd, supra; Kansas City Terminal Ry.* v. *Central Union Trust Co.*, 271 U. S. 445 (1926); *Consolidated Rock Products Co.* v. *Du Bois, supra.*

rank, but such allotments to the old senior securities have been upon more favorable terms, *i.e.*, at a lower price, than the allotments to the old junior securities.

In determining allocations among old securities secured by liens upon different assets, the Commission has recognized that the relative priorities of the different claims against over-all venture earning power necessarily depend upon the varying levels of the venture earnings at which the different assets securing the different claims show earning power. A main line of railroad will frequently show substantial earning power even when the system as a whole will be operating at a deficit. The relative priorities against over-all venture earning power also necessarily depend on the respective rates of acceleration of the earning power of the respective security assets as the venture earnings move up or down. The earnings experience of the various parts of a railroad property may demonstrate that, while at a given level of system earnings the earnings of two lines are substantially the same, the earnings of one line will accelerate much more rapidly than those of the other as system earnings increase above that level. It has therefore been the object of the Commission to fit old participating claims into the new capital structure at the levels of the respective contributions of their security to the venture earnings so that, as nearly as may be at every level of earnings, the new securities will produce for the claimant the "equitable equivalent" of what would have been produced by his old securities.

To assist it in reaching a judgment based not only upon its experience as an expert in the earning power of all the American railroads, but also upon "scientific" analyses by engineers and accountants, the Commission has in many

cases received voluminous "segregation studies,"[1] "severance studies,"[2] and "contributed traffic studies."[3] In any complicated case such studies obviously involve numerous assumptions, none of which can have any demonstrated certainty, and particularly do they involve informed and expert judgment. Even in those cases in which the experts have taken an entirely professional and judicial approach, as contrasted with one of advocacy, there has been no unanimity of opinion, and the results have been compromise approximations. While these studies have been helpful, and perhaps necessary, in determining allocations in complicated reorganizations involving many different securities having separate liens of equal rank upon many separate properties, the Commission has never sought to deduce from them any specific dollars and cents values for the separate properties so studied.

Nor has the Commission ever attempted any consideration of "market values" of properties or old securities or new securities. In the recent *Cotton Belt* case,[4] decided by

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[1]Studies in which earnings are allocated between different parts of the property on accounting and engineering bases believed by their proponents to have scientific foundation. Such studies are expressly provided for in Subsection (c) of Section 77.

[2]Studies in which it is sought to develop on the one hand the earning power of a particular line if its operation were severed from the remainder of the property, and on the other hand, the loss of earnings which the remaining property would suffer from the severance of the particular property, again all upon accounting and engineering bases believed by their proponents to have scientific foundation.

[3]Studies similarly purporting to establish on a scientific basis the amounts contributed by a particular line (usually one otherwise showing very low earning power) to the earning power attributed to the other lines in the "segregation studies."

[4]*St. Louis Southwestern Ry.*, 252 I. C. C. 325, 356 (1942).

the Commission since the *Western Pacific* decision of the Court below, the Commission recognized that the principle of allocation here urged

> "has been the customary method of the most successful railroad reorganizations of the past, and is generally well understood and acceptable in principle to the investors in securities of the highest grade. A reorganization based on expected value of the new securities on the immediate market would necessarily be much more drastic, and result in great, and in our view unnecessary, hardship to the junior creditors. Distress selling of defaulted bonds to bond speculators, and such markets as exist while such selling is taking place, do not, in our view, afford a proper basis for the reorganization of railroads for the long future term."

There have been but two exceptions to the Commission's refusal to give any weight to "market values":

(1) In those situations in which an old security was secured by property having a liquidation value readily realizable in cash in excess of the full amount of its claim, the Commission has sought to allocate to the claim so secured either cash or new securities having a presently estimated realizable cash value equal to the amount of the claim.[1] As we shall later see, the Trustees' Certificates constitute such a claim in the *Western Pacific* case.

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[1]For example, the holders of Birmingham bonds were allocated first mortgage fixed interest bonds for the full face amount of their claims in *St. Louis-San Francisco Ry.*, 240 I. C. C. 383, 417-8 (1940), and in *Chicago & North Western Ry.*, 236 I. C. C. 575, 633, 647-9 (1939); the plan provided that the Sioux City & Pacific first 3½s and the Des Plaines 4½s be exchanged for 4% divisional mortgage bonds.

(2) When, as also in the *Western Pacific* case, new money is required to be provided, the "market value" of the new securities to be issued for that purpose becomes relevant.

The practice of the Commission as thus outlined, it is submitted, is the only rational approach to a "fair and equitable" distribution of new securities designed to give to each existing class of securities its "equitable equivalent of the debtor's assets available for the satisfaction" of its claim. It insures to each participating class, as nearly as may be, the same position it formerly had in respect to the venture earnings at any given level, high or low, and in respect of the venture assets. Its validity has been sustained by every District Court before which any railroad reorganization plan of the Commission has been submitted for approval.[1] This has been true even in the three cases in which, although approving the Commission's method of approach, the District Court disagreed with the result.[2]

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[1] *In re Akron, Canton & Youngstown Ry.* (N. D. Ohio 1939, not reported); *In re Chicago Great Western R. R.*, 29 F. Supp. 149 (N. D. Ill. 1939); *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 36 F. Supp. 193 (N. D. Ill. 1940); *In re Chicago & North Western Ry.*, 35 F. Supp. 230 (N. D. Ill. 1940); *In re Denver & Rio Grande Western R. R.*, 38 F. Supp. 106 (D. Colo. 1940); *In re Erie R. R.*, 37 F. Supp. 237 (N. D. Ohio 1940); *In re Missouri Pacific R. R.*, 39 F. Supp. 436 (E. D. Mo. 1941); *In re New York, N. H. & H. R. R.* (D. Conn., Dec. 8, 1941, not yet reported); *In re St. Louis-San Francisco Ry.* (E. D. Mo., May 25, 1942, not yet reported); *In re Western Pacific R. R.*, 34 F. Supp. 493 (N. D. Calif. 1940).

[2] *In re Denver & Rio Grande Western R. R.*, 38 F. Supp. 106 (D. Colo. 1940); *In re New York, N. H. & H. R. R.* (D. Conn., Dec. 8, 1941, not yet reported); *In re St. Louis-San Francisco Ry.* (E. D. Mo., 1942, not yet reported).

While the utilities and other business ventures with the reorganizations of which the Securities and Exchange Commission has had to deal have seldom involved the complexities of different liens existing in most of the railroad systems dealt with by the Interstate Commerce Commission, the SEC has followed essentially the same principles as those adopted by the Interstate Commerce Commission in dealing with liens of the same rank upon different assets.[1]

This Court's decision in the *Consolidated Rock Products* case, relied upon by the Court below as requiring a different rule, does not prevent—it indeed requires—the method of allocation consistently followed by the Commission.

There can be no doubt of the soundness of the foregoing assertion when those words of the *Consolidated Rock Products* opinion,

> "a determination of that value [*i.e.*, of assets] must be made so that criteria will be available to determine an appropriate allocation of new securities * * *" (p. 524)

are read in the light of that opinion's insistence upon capitalization of prospective earnings, its recognition of the necessity for "practical adjustments," and its negation of any requirement for a "rigid formula."

On the other hand, it must be conceded that those who stress the importance of "market values" or present "worth" in allocating new securities, particularly as between old securities having liens of different rank on the same assets, can find some arguable support in certain phrases of the *Consolidated Rock Products* opinion. For example, for sur-

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[1] *In the Matter of West Ohio Gas Co.*, 3 S. E. C. 1014, 1026 (1938).

rendering senior rights creditors must be *"made whole. * * * Full compensatory provision* must be made for the entire bundle of rights which the creditors surrender;" they must receive *"full compensatory treatment"* and they "are entitled to have the *full value* of the property * * * first appropriated to *payment* of their claims. * * * So long as the new securities offered are of a *value equal to the creditors' claims*, the appropriateness of the formula employed rests in the informed discretion of the court."[1] But it is submitted that by those words the Court did not mean to hold either (1) that each class of senior securities, in the order of the old hierarchy, must receive new securities having a present *market* value equal to the full amount of the old claim before anything can be distributed to the next junior claim, or (2) that old securities having liens of equal rank on different assets should divide up the same classes of new securities on a market value basis in complete disregard of the differing relationships of earning power at different levels of venture earnings.

To attribute that meaning to the language of the opinion would be to disregard its stress of capitalization of earnings and reduce "reorganization value" to nothing but liquidation value based on the estimated "market value" of the new securities. Mathematically it would permit participation of claims only to a dollars and cents amount equal to the dollars and cents amounts of the estimated market value of the new securities, a result more harsh and drastic than has ever been imposed in the most drastic railroad reorganization plans either under the old equity practice or under Section 77. Such a construction would even more disregard the opinion's statement that "so long as

[1] 312 U. S. 510, at 528-30.

each group shares in the securities of the whole enterprise on an equitable basis, the requirements of 'fair and equitable' are satisfied." Such a construction would also render meaningless the famous dictum of the *Boyd* case, quoted with approval in the *Los Angeles Lumber* opinion, that its rule does not "require the impossible and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the reorganized company."

3. The Rule Imposed by the Decision Below

Rejecting the Commission's practical application in the *Western Pacific* case of the procedure outlined in the foregoing subsection 2, the Circuit Court below held that allocations of new securities between those entitled to participate in the reorganization must be "in proportion to the value of their respective claims." While it did not define what it meant by "value," its listing of sixteen separate items which it held must be valued indicates that it meant some kind of precise dollars and cents valuations.[1] The items so to be valued are not only the Debtor's properties in the aggregate, but the properties under each of its existing mortgages taken separately, and (apparently in disregard of the fact that the new First Mortgage and the new Income Mortgage are both to cover all the property of the reorganized company, being also all the property of the Debtor) separately, the property subject to each of the two new mortgages. In addition, it requires dollars and cents valuations of each of the existing claims against the Debtor (as to the RFC Notes, the RCC Notes and the ACJ Notes, stated not only severally, but also for the Refunding Bonds

[1] R. 2670-71; see p. 24, *supra*.

pledged to secure those Notes) and similar valuations of each class of the proposed new securities.[1]

The lack of any definition of what was meant by "value" as to each of the sixteen separate items makes it difficult to attempt application. However, if any single meaning be given to the term "value" as applied to all the sixteen items, the rule thus laid down becomes wholly unrealistic, exceedingly dangerous, and violative of the long line of decisions of this Court culminating in the decision in the *Consolidated Rock Products* case.

If by "value" the Court below meant "market value" as to all sixteen items, then, since it contemplates distribution "in proportion to the value of existing claims," and makes no distinction between old securities and new securities, it envisages that senior securities shall not receive "full compensation" for the full face amount, principal and interest, of their claims, but only new securities having a present "market value" equal to the present "market value" of the existing claims. This would mean, in the *Western Pacific* case, that the First

[1] While the Circuit Court of Appeals for the Seventh Circuit in the *Chicago, Milwaukee, St. Paul & Pacific* and *Chicago & North Western* cases (p. 71, *supra*, n. 1) followed the Ninth Circuit in holding inadequate, as to form, for allocation purposes, findings similar to those in the *Western Pacific* case, it not only failed to define what it meant by "value" but, probably because there would literally have been scores of detailed items on the Ninth Circuit theory, failed even to indicate what the express valuations should cover. The uncertainty of the Seventh Circuit as to the soundness of any such valuation requirements was accentuated by its decision in the *North Western* case that such valuations were merely procedural and were waived either as the result of the express assents of securityholders or as the result of assents which the Court assumed to "accept the responsibility" to give for the non-voting securityholders.

Mortgage Bondholders could have been satisfied at any time since 1933 by any sort of new securities having a "market value" of not more than 50—today approximately 35—, while junior securities (none of which have any market in their specific form) would have received some participation based on the estimated "market value" of the existing securities and the estimated "market value" of the new securities. After these "market values" had been estimated, a mathematical proportion between such "values" would be determined and the new securities distributed upon that basis in disregard of the relative positions of the existing claims against the venture earning power and the venture assets. Any such rule would obviously preserve junior securities having purely speculative market values at the expense of senior securities, whose market values would be depressed by the very fear of such a rule.

The rule is almost equally fantastic if it be assumed that the Court below really did mean by "value," as applied to all sixteen items, what the decisions of this Court establish to be the true test of "reorganization value," viz., capitalization of prospective earnings.

By hypothesis there is "full value" in all the securities embraced within those constituting the aggregate capitalization representing such "reorganization value." Such of them as have a par value must thus be treated as having a "reorganization value" substantially equal to their par value, whatever their rank, and such of them as have no par value must be treated as having a "reorganization value" equal to the amount at which they are allocated to "make whole" the most senior class of old securities. Otherwise, if the lower classes of the new securities are

reduced in their "reorganization value," the upper classes immediately attain a "reorganization value" materially in excess of their par value, or the aggregate "reorganization value" will not be maintained. The rule of the Court below becomes wholly meaningless under such an interpretation of its use of the word "value." Claims having successive liens upon the same assets, but each of them entitled to full participation in the reorganization upon the basis of capitalized prospective earnings, would be equal in "value" to each other and hence entitled to get exactly the same new securities irrespective of their old relative positions.

The futility of the added words incorporated by the Commission in its recent reports and orders in an attempt to conform them to the requirements of the decision below for the purpose of excluding classes of creditors and stockholders whose interests "have no value" has been noted above.[1] Attempted conformation to the rule for distribution stated in the decision below is reduced to an absurdity in the language used by the Commission in such an attempt in the *Cotton Belt* case.[2]

There, after a finding of an aggregate value of $75,000,000, being the permissible maximum capitalization or "reorganization value," the Commission continued by finding that "the sum of the undisturbed and new securities, representing as they do the sum of the interests of all those who will have an interest in the properties of the reorganized company, are of the same $75,000,000 value" and that "the new securities may be equitably exchanged for the existing claims on the basis of $1 par value of any of the new securities for $1 of value of existing claims."

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[1] Page 77, *supra*.

[2] *St. Louis Southwestern Ry.*, 252 I. C. C. 325 (1942).

Taken literally, this means that it would have been "fair and equitable" to have allotted the most senior old bonds $1 par value of new common stock for $1 of such senior claim, while at the same time allotting $1 of the most senior new bonds to $1 of the most junior old claim admitted to participation.[1] Of course the Commission meant no such thing.

This mumbo-jumbo "valuation" of the new securities, however, left but half done (or perhaps only one-third done) the task of making the valuations required by the Court below for distribution by mathematical proportions. There still remained the necessity of finding separate dollars and cents valuation for the various lien properties and for each of the old securities.

That additional step the Commission found both impossible and futile. It stated:

> "The properties comprise one operating unit; a complete separation of values would necessarily have to be based on extensive assumptions of unprovable validity; and any attempt at such a separation would in the end serve no purpose except to present an apparent certainty in the formulation of the plan which does not exist in fact. The Act calls for valuations only where necessary, and in our view further valuations are not necessary here."[2]

In the *D. & R. G.* case[3] (the Commission's most recent dealing with the problem), after analysis of the segregation, severance and contributed traffic studies before it, and full

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[1]The absurdity of this result demonstrates the necessity that relative priorities be maintained.

[2]*St. Louis Southwestern Ry., supra*, p. 92, at p. 361.

[3]Finance Docket No. 11002 (July 13, 1942).

statement of "the reasons for its conclusions," the Commission followed in principle the same method of allocation adopted by it in the *Western Pacific* case and above outlined in subsection 2. No reference was made to the decision of the Court below in the *Western Pacific* case nor was any effort made to give even colorable observance to the rule there laid down.

If the objective of a reorganization is to give to each existing class of securities its "equitable equivalent of the debtor's assets available for the satisfaction" of its claim, is it not clear that that objective can best be attained by valuing existing claims in terms of the new securities? Is not the problem one of comparing an old "bundle of rights" with a new package of different rights evidenced by new securities, which may be of one or more classes? What contribution will be made to the attainment of that objective —or to insuring that holders of old securities will be fitted into the new capital structure at the levels of their respective priorities in the venture earnings, and, at any given level of earnings, receive on their new securities the substantial equitable equivalent in income and assets of what their old securities would have produced—by attempting to reduce all of the old securities and all of the new securities to a fictitious common denominator expressed in terms of dollars and cents?

The impossibility of valuing a railroad property, even as an entirety, in terms of dollars and cents, has often been recognized by this Court.[1] Even more impossible is it to ascribe absolute dollars and cents values to parts of a system. Reference has already been made to the practical difficulties of the Commission in applying the rational rule

[1] See pp. 41-42, *supra*.

which it does apply in its present practice. What possible realism could there be to an effort to d duce, from segregation, severance and contributed traffic studies, precise dollars and cents values for pieces of a main line and various branches having separate underlying first liens and overlapping second and third liens?

Reorganization is primarily a business or administrative problem, once the technical legal rights of the parties under their contracts are determined. This is particularly true of a determination of the "reorganization value" of those legal rights, and of the "full satisfaction" or "payment" or "making whole" of those rights in terms of new securities. Section 77 as administered by the Commission has eliminated "bargaining" among securityholders, based upon their self interest and their experience in security values, as the method of solving the problem of allocation. It is submitted, however, that Section 77 did not substitute any fictitious mathematical formula as the *sine qua non* of the "fair and equitable" plan. It left the problem of such allocation to the expert judgment of a body already long experienced in the problems of security values before Section 77 was enacted. It may be that the Commission, as the substituted "reorganizer," might well have secured greater expedition of this and other reorganizations, without loss of a judicial approach to the "fair and equitable" problem, by the informal mediation conferences urged upon it by all the parties in the *Western Pacific* case.[1] However, be that as it may, the Commission has dealt with the problem of allocation scientifically, sensibly, fairly and in a practical manner. This Court should place the stamp of approval upon the Commission's methods of valuation and

[1] *Cf.* Bourne, *Findings of "Value" in Railroad Reorganizations* (1942) 51 Yale L. J. 1057, 1090.

allocation and should, by reversing the decision below in the *Western Pacific* case, refuse to hamstring the reorganization process by tying it up with impossible mathematical red tape which can only produce years of litigation and result in nothing but wasteful expense to all concerned.

4. The Allocations Under the Commission Plan

(a) Allocations as Between the First Mortgage and the Refunding Mortgage.

The correctness of the decisions of the Commission and the District Court that the First Mortgage is a first lien, subject only to the Trustees' Certificates, upon all the assets of the Debtor and the Trustees except for certain securities specifically pledged with the Refunding Mortgage Trustee, is assumed in this discussion. Affirmance by this Court of those decisions will be urged in separate briefs.

The First Mortgage Bonds as of January 1, 1939, had for each $1,000 of principal claim an equally secured claim for accrued interest of $266.67. Upon that aggregate claim of $1,266.67 each is entitled by contract to receive 5% interest annually.

The Commission Plan requires the following surrenders of rights and seniority by the First Mortgage Bondholders:

> 1. Upon no part of their claim are they hereafter to receive fixed interest. The likelihood of their ever receiving the income to which they are presently entitled is, if the record of past earnings analyzed above is any criterion, somewhat remote.[1]

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[1] Pages 57-68, *supra*.

2. In respect of 40% of the principal amount of their Bonds they are to receive new Income Mortgage Bonds with an annual interest rate of 4½%, or 10% less than the 5% to which they are presently entitled.[1] This new 4½% rate is to be contingent upon income, and to the extent that deficiencies of income exceed three years' interest at the reduced rate, the bondholders are wholly deprived even of the reduced rate of return.

3. In respect of 60% of the principal amount of their Bonds they are to receive new Preferred Stock. As to that 60%, they are to be transferred from a creditor position to the position of a stockholder. While their annual rate of return remains unchanged at 5%, such return is to be dependent wholly upon annual income, and to the extent of any income deficiency, is lost forever. The income on which they must hereafter depend is that *after* income and excess profits taxes; whereas as creditors they came ahead of such taxes. Moreover, dividends on the Preferred Stock (though cumulative to the extent earned) need not be paid unless the Board of Directors of the new company deems payment advisable.

4. In respect of that part of the claim representing the accrued and unpaid interest on their Bonds to January 1, 1939, they are not only to be transferred

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[1]The Committee urged before the Commission that the Income Mortgage Bond interest rate should be 5%, believing that no consideration of public interest required the sacrifice imposed upon the First Mortgage by reducing the existing rate. Complaining junior interests, however, urged that the rate should be but 4% and that the contingent interest should be wholly non-cumulative.

from a position of creditor to the position of stockholder, but the relative priority of that portion of their claim against the assets of the Debtor is to be taken away by the simultaneous allotment of Common Stock to the pledgees of the junior Refunding Bonds as against the second lien of those Bonds. The allotment to junior creditors is upon terms not substantially less favorable than the terms upon which the Common Stock is allotted to the First Mortgage Bondholders. The price to the First Mortgage Bondholders is $57 per share; to the RCC Notes $62 per share.

In partial compensation for the drastic sacrifices, both of principal position and income rights, imposed upon the existing First Mortgage Bondholders as above outlined, the Commission found that the public interest permitted incorporation in the new securities proposed under the Commission Plan of the following features, all of which were objected to in the Courts below by the junior interests:

1. A Sinking Fund, amounting to ½% of the principal amount of outstanding Income Mortgage Bonds annually, but dependent upon the existence of available net income, is created for the redemption or purchase of Income Mortgage Bonds;

2. The new Income Mortgage Bonds are convertible into new Common Stock at the rate of 20 shares for each $1,000 Bond; and

3. The new Preferred Stock is made participating with the Common Stock, share for share, in dividends paid in any year after the payment in such year of dividends of $3 per share on the Common Stock.

As between the First Mortgage and the Refunding Mortgage considered as liens of successive rank on substantially all the Debtor's assets (and it will be seen in our later discussion that the first lien of the Refunding Mortgage represents a relatively small portion of the assets), there may be some question whether this treatment of the First Mortgage Bondholders affords them the full compensation for their surrendered rights contemplated by the *Consolidated Rock Products* case. Certainly the three features above enumerated, and objected to by the junior interests, afford slight compensation to the First Mortgage Bondholders for the drastic sacrifices imposed upon them. That these three compensating features do not violate any rights of the objecting junior interests would seem to be beyond reasonable doubt.

The objections that the Sinking Fund of ½% of the principal amount of the outstanding Income Mortgage Bonds, payable only out of available net income after Income Mortgage Bond interest, would interfere with future financing through stock and would depreciate the stock allotted to junior interests by applying to retirement of the Income Mortgage debt cash which otherwise might be applicable to dividends on that stock, seem to demonstrate their lack of merit by their very statement.[1]

The conversion privilege attaching to the Income Mortgage Bonds, to which the junior creditors have objected, furnishes, on the basis of the Debtor's earnings record,

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[1]Similar objections have been overruled in *In re Chicago Great Western R. R.*, 29 F. Supp. 149 (N. D. Ill. 1939); *In re Chicago & North Western R. R.*, 35 F. Supp. 230 (N. D. Ill. 1940); and *In re Chicago, Milwaukee, St. Paul and Pacific R. R.*, 36 F. Supp. 193 (N. D. Ill. 1940).

rather illusory compensation for the "lost rights" of the First Mortgage Bondholders. Before the conversion privilege can ever be of value the reorganized company will have to establish a *seasoned* record of payment of dividends in excess of $2.25 per share. This would require *sustained* annual earnings in excess of $4,260,000, an amount earned by the Debtor in only three of the last twenty years.

Similarly, the objection of the junior interests that the participating right of the new Preferred Stock in dividends after annual Common Stock dividends of $3 per share depreciates the allotment to the junior interests would seem to be baseless. The average earnings illustrated by the graphs opposite pages 58 and 59, *supra,* indicate that, in all of the average periods of the past there considered, the Preferred Stock dividends, and in most of those periods also the Income Mortgage Bond interest, would have failed of realization by substantial amounts. The limited accumulation of unearned Income Bond interest and the absence of accumulation of unearned Preferred Stock dividends means that the First Mortgage Bondholders will lose forever a substantial part of the income required as the "equitable equivalent" of their present income rights. Before the participating right will be effective the reorganized company will have to earn in excess of $4,600,000 annually, an earnings record, as already pointed out, not in reasonable contemplation for the estimable future. Certainly this participating feature also affords but illusory compensation for lost income rights of the First Mortgage Bondholders.

In dealing with the relative allocations of securities between the First Mortgage and the Refunding Mortgage in respect of the assets as to which they are, respectively, first

liens, the Commission Plan is liberal to the Refunding Bonds.

There are physically pledged with the Trustee under the Refunding Mortgage securities constituting all the funded debt and 97.87% of the stock of Tidewater Southern, 33⅓% of the bonds and stock of Central California Traction, and 49.4% of the stock of Alameda Belt Line.[1]

In its Original Report and Order the Commission allotted only new Common Stock in respect of this collateral.[2] On reconsideration upon the Petition of the Refunding Mortgage Trustee, the Commission, in its final Report and Order, found that the Tidewater Southern properties were of value, but that the lien of the Refunding Mortgage upon the securities of Central California Traction Company and Alameda Belt Line "has no material value."[3]

The simplicity, in the *Western Pacific* case, of this problem of allocation between the two liens of equal rank upon different assets (*i.e.*, determining the value of the Refunding Mortgage first lien assets in relation to the great part of the system upon which the First Mortgage is a first lien) obviated the necessity for the elaborate segregation, severance and contributed traffic studies which the Commission has used in the more complicated reorganization cases. Nevertheless, from the very fact that the three Refunding Mortgage properties are separately operated and maintain separate accounts, the Commission did have before it what was in effect a segregation study. A study

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[1]In addition there are so pledged some admittedly worthless notes of other subsidiaries (R. 1095).

[2]R. 270-1. [3]R. 315.

of the traffic contributed by each of the three properties to the System was also made.[1]

This valuation data evidenced that the average operating loss of the Central California Traction Company during the 12 years 1928 to 1939, inclusive, was in excess of $14,000 per year,[2] while that of the Alameda Belt Line was about $28,000 per year,[3] and that the Debtor had made cash contributions to the deficit burden of carrying the properties for the Central California Traction property during the period 1928 to 1938, an average of $31,919 per year, and, for the Belt Line, $22,095 per year.[4]

While the record showed that the traffic carried by other lines of the Debtor which originated or terminated on the Central California Traction and Alameda Belt properties was substantial,[5] there was no evidence that that traffic would not have come to the Debtor even if it had not had its fractional investments in those separate companies. Nor did the record show how much of the gross revenues upon the traffic so obtained by the Debtor had been carried through to net. It would seem doubtful upon the record whether the Debtor realized, upon the traffic so contributed and which it carried upon interchange, an amount any more than sufficient to offset its contributions toward the deficits of the two properties.

The "valuation data" in respect of these two properties therefore affirmatively established the correctness of the Commission's findings that they "do not appear to be of much value, except as the debtor through such holdings

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[1]R. 1950, 1954, 2019, 2037, 1105-6.
[2]R. 2019, 2084-5, 1100, 1309.
[3]R. 2019, 2088-9, 1103, 1111.
[4]R. 1101, 1104-5.
[5]R. 2019, 2037, 1105-6.

may be able to secure traffic for its lines which it might not otherwise be able to secure. * * * Thus the lien on the securities of these two companies has no material value."[1] Nevertheless, as is indicated below, some recognition of a possible value of that lien is included in the Common Stock allocated to the RCC and ACJ Notes.

The Commission found the rate-making value of Tidewater Southern in an amount representing 1.3% of the comparable System valuation, and the reported earnings for the six year period 1930-1935, in an amount representing 7.2% of adjusted System earnings, before deducting therefrom the Debtor's contributions to the deficits of the Central California Traction and the Alameda Belt Line. While the Commission recognized that on the basis of this valuation data "the Tidewater Southern is a paying railroad and also a valuable feeder," the Commission also recognized that as the owner of all the funded debt and 97.87% of the outstanding stock of Tidewater Southern the Debtor's determination of its rate divisions with that property was not a matter of arms-length negotiation nor of any importance except in reorganization. "Its earnings," said the Commission, "are, to a large extent, dependent upon the divisions of joint rates accorded it by the debtor."[2]

The Commission, upon its analysis of all the "valuation data" before it, allotted to the Refunding Mortgage first lien property 3.5% of the total Income Bonds and Preferred Stock to be issued in the reorganization, and it gave further recognition to the value of that property by the allocation of Common Stock, as next explained.

Both the second lien of the Refunding Mortgage upon the assets upon which the First Mortgage is a first lien,

[1]R. 314-5. [2]R. 315.

and the Refunding Mortgage first lien assets were given further recognition by allocating to the RCC Notes and the ACJ Notes all the Common Stock remaining out of the aggregate "reorganization value" after making the allocations to the First Mortgage Bondholders hereinbefore explained and the compromise allocations to the RFC Notes discussed below.[1] Because this last-mentioned compromise, as will be later seen, allotted to the RFC Notes, 29,360 shares less of Common Stock than the amount to which its proportion of pledged Refunding Bonds would entitle it out of the amount allotted to the Refunding Mortgage, the effect of the compromise was to increase the amount of Common Stock distributed to the RCC Notes and the ACJ Notes.

The ultimate result of these allocations is that RCC Notes are allocated Common Stock at $62 per share. There may be doubt whether the difference between this price and the $57 per share at which the new Common Stock is allocated to the First Mortgage Bond interest sufficiently recognizes the priority of the First Mortgage Bonds. Whatever error there may be thus favors the objecting junior interests.

(b) Allocations as Between Pledgees of Refunding Bonds

The RFC Notes, the RCC Notes, and the ACJ Notes are secured by the pledge, respectively, of 56.6%, 21.1%, and 22.3% of the outstanding Refunding Bonds.

The Commission found that the securities available for distribution against the Refunding Bonds are "inadequate in value to satisfy the aggregate claims of" the pledgees,

[1] Page 107, *infra*

that the "allocation of reorganization securities" to RFC "exhausts the value of the collateral pledged" under the RFC Notes and that hence the equity of RCC in such collateral "has no value."[1]

As has been fully pointed out in the discussion of the valuation data supporting the Commission's finding that the unsecured debt and stock of the Debtor "have no value," these additional findings by the Commission constituted, by simple mathematical computation, a finding that the aggregate "reorganization value" of the Debtor's properties, and of the new securities available for distribution, did not exceed $84,027,559. The conclusive force of the valuation data in support of these findings has already been indicated.

Where two or more primary claims against a debtor (*e.g.*, collateral notes, such as the RFC, RCC and ACJ Notes) are secured by the pledge of unequal amounts of mortgage bonds of a debtor equally secured under the same mortgage, the pledgees, as between themselves, share in the net proceeds of the assets of the estate according to the face value of the pledged bonds held by them (*i.e.*, are entitled to dividends on the pledged bonds in the enforcement thereof at the same rate per pledged bond) until, in the case of each pledgee, its primary claim (*i.e.*, the claim for which the bonds were pledged) is paid in full as to both principal and interest.[2]

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[1] R. 271, 316.

[2] *Richardson's Executor* v. *Green*, 133 U. S. 30 (1890); *Merrill* v. *National Bank*, 173 U. S. 131 (1899); *Equitable Trust Co.* v. *Great Shoshone & T. F. W. P. Co.*, 228 Fed. 516 (D. Idaho 1915); *Central Trust Co.* v. *Cincinnati, H. & D. Ry.*, 169 Fed. 466 (C. C. S. D. Ohio 1908); *Sauve* v. *Fleschutz*, 219 Fed. 542 (C. C. A. 8th, 1915).

The Commission's findings as to the reorganization value of the Refunding Mortgage interest in the Debtor's properties compelled the application of the principle of law above stated. Hence they compelled the findings of the Commission that "the value of each of the claims" (*i.e.*, RFC, RCC and ACJ Notes) "is proportionate to the collateral securing it," and that the allotment of new securities respecting the pledged Refunding Bonds "should be made on the basis of the collateral held rather than on the amount of the claims."[1] The Commission, therefore, properly, as a matter of law, allocated to the RCC Notes and the ACJ Notes out of the new Income Mortgage Bonds and Preferred Stock allocated to the Refunding Mortgage, amounts of those new securities in the proportions which the pledged Refunding Bonds held by them respectively bore to the aggregate amount of pledged Refunding Bonds.

All the permissible Common Stock remaining after the allocation to the First Mortgage above discussed and to the RFC Notes under the compromise next discussed, was divided between the RCC Notes and the ACJ Notes, in the proportions which their pledged Refunding Bonds bore to each other. As already noted, the compromise with the RFC Notes resulted in such allocation of an amount of Common Stock substantially larger than would have been available had there not been such a compromise.

This allocation among the pledgees of the Refunding Mortgage Bonds was the one feature of the Commission Plan which permitted—indeed required as a matter of law—application of a mathematical formula. No other type of allocation would have lawfully recognized the relative priorities of the respective pledgees.

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[1] R. 271.

(c) THE COMPROMISE OF RFC'S ENTIRE "BUNDLE OF RIGHTS"

As of January 1, 1939, RFC was the holder of $10,000,000 Trustees' Certificates and a claim for $3,862,869.98 on the RFC Notes. This latter claim was secured by a first lien pledge of $10,750,000 principal amount of Refunding Bonds or 56.6% thereof. This pledge was at the rate of $3,628 of Refunding Bonds for each $1,000 principal amount of Notes as compared with a pledge at the rate of $1,635 of Refunding Bonds for each $1,000 principal amount of the RCC Notes.

That the Trustees' Certificates which originally matured in 1935 and 1936,[1] and have since been extended from year to year, could enforce, and readily realize, payment in full in cash upon any maturity has always been conceded by all the parties. The refunding of these Trustees' Certificates has been a foremost problem of the reorganization from the beginning of the negotiation of a reorganization plan following the Debtor's default in First Mortgage interest in 1934.

This was true even in advance of the issue of the Trustees' Certificates, for it was then known that the $10,000,000 would have to be raised to rehabilitate the property and make good deferred maintenance, and it was equally known that the only then available source of such funds was the purchase of Trustees' Certificates by RFC.

It has also been recognized throughout the reorganization proceeding that, in the state of railroad credit which has existed, and still exists, ultimate refunding of the Trustees' Certificates into long-term securities would probably

[1] R. 1054-6.

require resort to RFC and that the consideration to be furnished to RFC for supplying long-term funds on a basis more favorable than current market prices would probably have to take the form of granting to the RFC Notes treatment more favorable than RFC might deserve on the basis solely of the pledged Refunding Bonds. Accordingly, save for but one proposal,[1] every one of the more than a dozen different plans proposed by the various parties before the Commission contemplated that RFC would permanently fund the $10,000,000 for a consideration.

The Commission Plan dealt with the problem by allotting to RFC in exchange for its entire "bundle of rights" $10,000,000 new First Mortgage Bonds having an admittedly prospective realizable market value less than the value of the Trustees' Certificates, and participation in respect of the RFC Notes on the same basis as an equal amount of old First Mortgage Bonds.

Before the Commission there was no attempt at testimony as to the prospective market values of the new First Mortgage Bonds. The Commission, however, by reason of its experience in the regulation of railroad security issues and its consequent continuous familiarity with market values, was an expert as to what would constitute a fair consideration for the RFC's permanently funding the $10,000,000 Trustees' Certificates into such Bonds.

There was evidence before the District Court as to the probable market value of the new First Mortgage Bonds, both in connection with the District Court's hearing upon

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[1]R. 104. This one exception was an early proposal by ACL that the money be provided by WP Corp. However, WP Corp. was not a party to the proceeding before the Commission and no one ever gave the slightest assurance that it could or would provide the $10,000,000.

the Commission Plan[1] and again upon an abortive attempt made by ACJ to render the Commission Plan incapable of consummation by denuding the Trustees of cash in order to pay off the Trustees' Certificates.[2] That evidence indicated a probable market value of the new First Mortgage Bonds of between 85 and 90, so that the new First Mortgage Bonds to be taken by RFC are probably worth from $1,000,000 to $1,500,000 less than the amount readily realizable in cash on the Trustees' Certificates.[3]

Were RFC to receive for the RFC Notes amounts of new securities proportionate to its pledged Refunding Bonds it would receive

$414,175 new Income Bonds
$649,518 Preferred Stock
45,148 shares of new no par value Common Stock.

Under the allotment of the Commission Plan, *pari passu* with the existing First Mortgage Bonds, it receives

$1,185,200 new Income Bonds
$1,777,800 new Preferred Stock
15,788 shares of new no par value Common Stock.

Thus, in order to facilitate a reorganization of the Western Pacific, a legitimate objective for this Government corporation, RFC will accept for its "entire bundle of rights"

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[1]R. 1530, 1532, 1536, 1554.

[2]*In re Western Pacific R.R.*, 38 F. Supp. 877, 879 (N.D. Calif. 1941).

[3]First Mortgage Bonds of recently reorganized railroads were selling, as of July 31, 1942, at the following prices: Chicago & Great Western, 64; Erie, 90¼; Gulf, Mobile & Ohio, 67¾; Wabash, 78 (Commercial & Financial Chronicle, vol. 156, pp. 409-12).

$771,025 principal amount more Income Bonds, $1,128,282 par value more new Preferred Stock, but 29,360 less shares of new no par value Common Stock than it might have obtained against that "entire bundle of rights" by standing on those rights and requiring cash payment of its Trustees' Certificates. While the aggregate additional face amounts of Income Bonds and Preferred Stock thus allocated to RFC is slightly greater than the probable discount upon the $10,000,000 of new First Mortgage Bonds, obviously those new securities do not have a presently realizable value even approximating their face amounts. The consideration furnished by the increased amounts of these new senior securities allocated to RFC is further offset by the 29,360 shares reduction in the amount of Common Stock allocated to it.

The argument of the objecting junior interests that the two claims of RFC cannot be treated as a single "bundle of rights" but must be dealt with entirely separately is, it is submitted, without merit. The contention seems to violate the express language of this Court's opinion in the *Consolidated Rock Products* case.

If the fair compromise of the RFC's entire "bundle of rights" provided for by the Commission Plan is not adopted, not only the First Mortgage Bondholders, but to an even greater degree the RCC Notes and the ACJ Notes, will be seriously injured.

The rapidly mounting gross income of the Debtor's properties, before Federal taxes, is resulting in a rapid accumulation of cash by the reorganization trustees. As of September 1, 1942, the cash on hand and on deposit with RFC aggregated $10,493,000, of which a substantial amount, however, must be reserved for taxes and

deferred maintenance, as well as for the additions and betterments necessary to meet additional traffic demands. If any of the remaining cash is used to pay down, or possibly pay off, the Trustees' Certificates, so that the RFC Notes will be left to be dealt with solely upon the basis of their pledged Refunding Bonds, the reorganized company will be denuded of the cash necessary to service the new securities from January 1, 1939, the effective date of the Commission Plan. Not only will the First Mortgage Bondholders' realization of any cash income out of the earnings of their properties thus be substantially delayed to their own injury, but if the Commission Plan is thus rendered abortive, at least $10,000,000 more of interest will have accrued upon the First Mortgage since January 1, 1939. This will have to be provided for in any new plan with due recognition of its priority over the pledged Refunding Bonds.

5. Conclusion

The allocation of new securities under a Section 77 railroad reorganization plan between mortgage bonds having liens of different rank on the same assets and also liens on different assets must be on the basis of giving to each mortgage its "equitable equivalent of the debtor's assets available for the satisfaction" of its claim in terms of the various classes of new securities, having regard for the relative order of priority of the respective existing claims upon system earnings at the various levels represented by the proposed new securities and all other relevant factors, all as appraised by the Commission's expert judgment and subject to the court's approval of the result as fair and equitable within the limits stated in Point III of this brief.

Such allocation cannot be made "in proportion to the value of the respective claims" determined by dollars and cents valuations of properties, old claims and new securities, and no such valuations are necessary to determine fair and equitable allocations, except in those cases where it is necessary to determine whether the readily realizable market value of the assets securing an old claim exceeds the full amount of that claim.

The valuation data contained in the record supports the Commission's findings of the relative values, in terms of new securities, of the liens of the First Mortgage and the Refunding Mortgage, respectively, as well as the Commission's findings that the securities available for distribution to the RFC Notes, the RCC Notes and the ACJ Notes against the Refunding Bonds held by them as collateral are "inadequate in value to satisfy the aggregate claims" and that "the equity of" RCC in the collateral pledged under the RFC Notes "has no value." Hence, as a matter of law, the basic allocation of new securities as between the First Mortgage and the Refunding Mortgage made by the Commission violates no right of RCC or ACJ as pledgees of Refunding Bonds, and as between RCC and ACJ the new securities representing the pledged Refunding Bonds must be divided on the basis of the amounts of such pledged Bonds rather than on the basis of the amounts of the claims on the RCC Notes and the ACJ Notes.

The preferred claim of RFC on its $10,000,000 Trustees' Certificates and its junior claim on the RFC Notes may properly be dealt with as an "entire bundle of rights." The compromise of the aggregate RFC claims provided for by the Commission Plan is practicable and fair and in the interest of all of the securityholders of the Debtor.

Neither any apparent increase in the annual earnings of the Debtor's property (analyzed under subsection 5 of Point I above) nor the accumulation of cash by the reorganization trustees requires reconsideration of any of the Commission's findings or conclusions with respect to allocations.

III

THE DISTRICT COURT PROPERLY RECOGNIZED THE JURISDICTION OF THE COMMISSION UNDER SECTION 77 AND, IN THE EXERCISE OF AN INFORMED AND INDEPENDENT JUDGMENT, FULLY PERFORMED THE COURT'S FUNCTIONS UNDER SECTION 77.

1. Three Opposing Views

Three opposing constructions have been taken of Section 77 as to the relative jurisdictions of the Commission and the courts over the approval of a plan of reorganization.[1]

(1) The construction taken by the Circuit Court of Appeals in this case:

> None of the findings or conclusions of the Commission, whether as to questions affecting the "public interest" or as to questions affecting "the rights of each class of creditors and stockholders," are in any way binding on the court. The court must independently determine each such question as an original matter. Only if all its determinations coincide with all the determinations of the Commission may

[1] See Comment (1941) 51 Yale L. J. 967, at 972, *et seq.*

the court approve the plan approved by the Commission.

(2) The extreme opposite construction:

All the findings and conclusions of the Commission upon both types of questions are binding and conclusive upon the court except for errors of law. The court must therefore approve the plan approved by the Commission, in the absence of errors of law, if there is any evidence to support the Commission's findings of fact, notwithstanding that the court may be strongly of the opinion that the Commission's determinations of facts upon which depend the rights of classes of creditors and stockholders are contrary to the weight of the aggregate evidence, including both that in the record certified by the Commission and that taken by the court.

(3) The construction taken by the District Court in this case:

The findings and conclusions of the Commission upon questions affecting the public interest, *e.g.*, the amount and classification of the new capitalization, are binding and conclusive upon the court, in the absence of errors of law or lack of supporting evidence. The findings and conclusions of the Commission as to the rights of each class of creditors and stockholders are preliminary only. It is the duty of the court to exercise its independent judgment as to such questions, giving, however, great weight to the Commission's judgments upon such of the questions affecting such rights as to which the Commission is an experienced expert, *e.g.*, rela-

> tive earning power and values of properties and securities. If, notwithstanding absence of any errors of law, the court's judgment upon questions of fact affecting the rights of any class of creditors or stockholders (based both upon the evidence taken by the Commission and that taken by the court) differs from the preliminary findings of the Commission, it is the court's duty to return the case to the Commission for modification of the plan or other further action in accordance with Section 77.

This third construction the Committee believes to be both practical and required by the express language and the legislative history of Section 77.

2. Section 20a of the Transportation Act and Reorganizations in Equity

In *Prentis* v. *Atlantic Coast Line Company* Mr. Justice Holmes said:

> "A judicial inquiry investigates, declares and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand looks to the future and changes existing conditions by making a new rule to be applied thereafter to all or some part of those subject to its power."[1]

The determination of a capital structure for a railroad is essentially a legislative and not a judicial function.[2] When, therefore, in 1920, Congress vested the Commission

[1] 211 U. S. 210, 226 (1908).

[2] *Akron, Canton & Youngstown Ry. Co.* v. *Hagenbuch*, 128 F. (2d) 932, 940 (C. C. A. 6th, 1942).

with exclusive and plenary power to determine whether the issue of securities by a common carrier was in the public interest, Congress was delegating to the Commission a part of the Congressional legislative power.[1]

The Commission's action in exercising the power so granted has been uniformly upheld by the courts in every case of which we are aware,[2] with one exception.[3]

After the enactment of Section 20a, a railroad corporation organized to carry out a reorganization plan approved by a Federal court in an equity proceeding was obliged to obtain the authorization of the Commission before it could issue new securities under the plan in exchange for the old securities. As a result, the Commission was in a position to block a reorganization approved by a Federal

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[1]Transportation Act, 1920, § 268a; 49 U. S. C. A. § 20a.

[2]*New York Central Securities Co.* v. *United States*, 287 U. S. 12 (1932); *Miller* v. *United States*, 277 Fed. 95 (S. D. N. Y. 1921); *Pittsburgh & West Virginia Ry.* v. *I. C. C.*, 293 Fed. 1001 (App. D. C. 1923), appeal dismissed, 266 U. S. 640 (1924); *Equitable Trust Co. of New York* v. *Chicago, P. & St. L. Ry.*, 223 Ill. App. 445 (1921); *Chicago & E. I. Ry.* v. *Miller*, 309 Ill. 257, 140 N. E. 823 (1923); *Minneapolis, St. P. & S. S. M. Ry.* v. *Railroad Commission of Wisconsin*, 183 Wis. 47, 197 N. W. 352 (1924); *Whitman* v. *Northern Central Ry.*, 146 Md. 580, 127 Atl. 112 (1924); *City of Buffalo* v. *N. Y. Cent. R. R.*, 125 Misc. 801, 212 N. Y. Supp. 1 (1925), aff'd. 218 App. Div. 810, 218 N. Y. Supp. 713 (1926); *Snyder* v. *New York, C. & St. L. R. R.*, 118 O. St. 72, 160 N. E. 615 (1928), writ of error dismissed, 278 U. S. 573 (1928), judgment of dismissal vacated and case affirmed, 278 U. S. 578 (1928); *City of New York* v. *New York Cent. R. R.*, 275 N. Y. 287, 9 N. E. (2d) 931 (1937).

[3]*United States* v. *Chicago, M. St. P. & P. Ry.*, 282 U. S. 311 (1931). In that case the Commission sought to regulate reorganization expenses payable out of assessments for which new securities were not, at least in form, being issued. The majority of this Court held that such regulation could not be imposed as a condition of the Commission's approval of the proposed new securities under Section 20a.

court of equity by refusing approval to the issue of the new securities if it deemed such securities incompatible with the public interest. It was the practice, however, in the old equity reorganizations to bring the plan substantially to consummation, not merely through the determination of the nature and extent of the securityholders' rights, but through the steps of securityholder consents, final Federal district court approval and organization of the proposed reorganized corporation, before the Commission was asked to pass upon the proposed new capitalization from the standpoint of the public interest under Section 20a.

This practice left the Commission in a dilemma. To refuse approval of the proposed new securities would undo much work already done at great expense of both money and time, and, in the cases which arose, a majority of the Commission believed that the paramount public interest required that the receivership be ended and the properties returned to their owners rather than that otherwise desirable standards of public interest be enforced with respect to the proposed new capitalization. Of this dilemma the Commission began to complain as early as 1922[1] and its complaints accelerated in forcefulness[2] until the Commission, in strongest terms, declared that the then practice was "fundamentally unsatisfactory and requires reform."[3] It should be noted, however, that those complaints in no wise related to the courts' determinations of the contractual

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[1] *Missouri-Kansas-Texas Reorganization*, 76 I. C. C. 84 (1922). See particularly Commissioner Eastman's remarks at page 108.

[2] See *Denver & Rio Grande Western Reorganization*, 90 I. C. C. 141, 158 (1924).

[3] *Chicago, Milwaukee & St. Paul Investigation*, 131 I. C. C. 615, 671 (1928).

rights of the securityholders and involved no suggestion that the courts should be deprived of their ultimate jurisdiction over such determinations.

The Commission's dissatisfaction was shared by Congress. The flood of railroad bankruptcies which began in 1932 resulted in a demand for resort to the Federal bankruptcy powers for a new railroad reorganization procedure which would obviate the fictions of the old equity receiverships, the possible disruptions through ancillary receiverships, and the necessity for providing cash to meet the claims of small minorities of securityholders not assenting to approved reorganization plans.[1] But even more insistent was the demand that any new reorganization procedure should require submission of the plan to the Commission at an early stage of the proceeding in order primarily to enable it to pass on those questions affecting the public interest, *i.e.*, those relating to capitalization and classification of capitalization. Consequently, Section 77 reversed the previous practice of first submitting railroad reorganization plans to the courts for determination of the private rights of the securityholders *inter se*, and thereafter submitting them to the Commission for determination of questions of public interest.

Indeed the new legislation, as has already been stated, created a procedure under which the Commission has in effect become substituted for the securityholders as the "reorganizer" and its expert judgments substituted for the "bargaining process" among securityholders for the determination in the first instance, not only of the over-all ques-

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[1]Rodgers and Groom, *Reorganization of Railroad Corporations under Section 77 of the Bankruptcy Act* (1933) 33 Col. L. Rev. 571, 572.

tions of public interest, such as the total amount and character of capitalization to be issued in the reorganization, but also of the financial and other factual problems affecting the distribution of that capitalization in accordance with the legal rights of the old securityholders.

3. The Reorganization Process under Section 77

Under subsection (d) of Section 77, proposals of railroad reorganization plans are made by filing them with the Commission. Thereafter the Commission holds public hearings. Following such hearings,

> "* * * the Commission shall render a report and order in which it shall approve a plan, *which may be different from any which has been proposed*, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; * * * In such report the Commission *shall state fully the reasons for its conclusions.*"

It will be noted that in approving a plan the Commission must:

(1) *Determine* that it will be compatible with the public interest;

(2) Be of the *opinion* that it will meet the requirements of subsection (b)[1]; and

(3) Be of the *opinion* that it will meet the requirements of subsection (e).[2]

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[1]Subsection (b) deals largely with the mechanics of the plan, as to which no question was involved on the appeals below.

[2]The material portions of subsection (e) are quoted on pp. 120-21, *infra*.

Subsection (d) further provides that the Commission may, upon petition and further hearing, "in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification."

The power of the Commission to control formulation of the plan, subject only to such judicial determination as may be required by Section 77 itself or by general constitutional principles, is emphasized by the further provision of subsection (d) that

> "No plan shall be aproved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission * * *."

Upon the approval of a plan by the Commission, the Commission shall "certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan."

Subsection (c)(7) of Section 77 vests in the judge the duty to "determine * * * for the purposes of the plan * * * the division of creditors and stockholders into classes according to the nature of their respective claims and interests."

Subsection (e) requires that the judge shall hold a hearing upon such "objections" to the plan and "claims for equitable treatment" as may be filed by the parties with the court. At such hearing the judge may receive evidence. After such hearing the judge *shall* approve the plan if *satisfied*[1] that it

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[1]The Committee agrees with the contention of the junior interests below that "satisfied" means satisfied with the ultimate proof itself, rather than the ordinary test in judicial review of administrative action—whether the administrative agency acted lawfully and on substantial evidence.

(1) "complies with the provisions of subsection (b) * * *;" and

(2) "is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders;" and

(3) complies with certain other requirements respecting expenses and fees incident to the reorganization and administrative costs (as to which no question has been raised in the present case).

Subsection (e) further provides

"If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect * * *."

If the judge shall not approve the plan, subsection (e) provides that he shall either dismiss the proceeding or refer it back to the Commission with his opinion, "stating his conclusions and the reason therefor" and "a copy of *any evidence received.*"

It will be noted that Section 77 does not vest in the court either

(1) jurisdiction to determine whether the plan is "compatible with the public interest" as required by subsection (d); nor

(2) jurisdiction to make original and independent proposals of a plan, if the plan approved by the Commission meets the requirements of subsections (b) and (e), even though the court may be of opinion that some better plan might be devised.

Of course in every complicated situation there may be several plans which might be "compatible with the public in-

terest," but it is that particular plan which the Commission approves as "compatible with the public interest" which "*shall*" be approved by the court if the court is *satisfied* that that plan meets the requirements of subsections (b) and (e) with respect to the private rights of the various classes of creditors and stockholders. No other plan *can* be approved by the court.

4. Extension of the Commission's Power Under Section 20a of the Transportation Act to Reorganizations Under Section 77

The words "compatible with the public interest", like the words "fair and equitable", had become words of art prior to their incorporation in Section 77. Not only Section 20a of the Transportation Act, but subsections 3 and 7 of Section 5, as well as other sections of the Interstate Commerce Act (49 U. S. C. § 1 *et seq.*), required determinations under the test of compatibility with the public interest. The standards applied in all those determinations related to financial and physical capacity for public service and performance of such service, as contrasted with the standards applicable to the determination of litigation between securityholders as to their respective contractual rights in specific property.

More than a decade prior to the enactment of Section 20a the Commission began to urge that for the protection of the public some reasonable regulation should be imposed upon the issuance of securities by railways. In its report on *Consolidations and Combinations of Carriers*, 12 I. C. C. 277, 305, 306 (1907), the Commission said:

> "It is a serious menace to the financial condition of the country to have large railway systems fail to

meet their obligations or go into the hands of receivers, and the object of legislation and administration should be to lessen the risks of railway investments.

* * * * * * * *

"It is of the utmost importance, also, that railway securities should be safe and conservative investments for the public, and should yield good and ample return for the money invested. Reasonable regulation will tend to make them safer and more secure investments, and thereby benefit not only the railway companies but the public."

Following the enactment of Section 20a, the Commission repeatedly held that the public interest did not permit the issue of securities on which probable earnings would be insufficient to pay charges. In *Denver & Rio Grande Western Reorganization*, 90 I. C. C. 141, 148 (1924), the Commission said:

"The public interests require that, before an issue of securities by a carrier is authorized, the probability of earnings sufficient to pay costs of operation and of fixed charges be reasonably established, with some surplus for dividends and other purposes."

The Commission has often forbidden the issuance of securities where it found that the prospective earnings were not sufficient to justify such issue.[1]

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[1] *Bond Application of Texas Short Line Ry.*, 67 I. C. C. 400 (1921); *Securities Application of Asherton & Gulf Ry.*, 71 I. C. C. 281 (1922); *Securities of L. Ry & Nav. Co. of Texas*, 99 I. C. C. 357 (1925); *Securities of Yankton N. & S. R. R.*, 154 I. C. C. 669 (1929); *cf. N. Y. L. & W. Stock and Bonds*, 131 I. C. C. 34 (1927); *St. Paul & K. C. S. L. R. R. Bonds*, 189 I. C. C. 715, 716 (1933).

The essential jurisdiction of the Commission under Section 20a is carried into Section 77 not only by the requirement that the Commission shall formulate a plan "compatible with the public interest". By the fifth sentence of subsection (f), jurisdiction under Section 20a itself is specifically preserved to the Commission. That subsection provides:

> "* * * Upon confirmation of a plan the Commission shall, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of the Interstate Commerce Act as now or hereafter amended."

Any doubts respecting the carrying over into Section 77 of the powers of the Commission under Section 20a are completely removed when the legislative history of Section 77 is examined. The report dated January 23, 1933, of the Committee on Judiciary of the House, of which Representative Sumners of Texas was Chairman, stated in part:

> "Subdivision (f) provides for the final approval of the plan by the Interstate Commerce Commission and, after such approval, for the certification of the plan to the court for its approval. After the acceptance is filed with the commission * * * the commission exercises its powers under section 20a of the interstate commerce act on the approval of issuance of securities necessary in the reorganization. This * * * retains an absolute and complete control

of the reorganization in the Interstate Commerce Commission of the plan recommended and approved by it."[1]

To the same effect are the remarks of Representative LaGuardia of New York, a member of the Committee on Judiciary of the House, who took an active part in guiding the bill through the House.[2]

Congress, therefore, in the enactment of Section 77 clearly contemplated that the Commission would, as it did in the Commission Plan, require that a railroad reorganization plan shall "provide a capital structure for the reorganized company which will give it a reasonable opportunity to function efficiently and continuously as a going concern", "that the capitalization should not exceed a conservative appraisal of the assets to be taken over by the reorganized company", "that proposed charges, whether fixed or contingent, be within * * * probable earning power" and that the capitalization should "be maintained within strict limits" to insure that "the shares of its stock should not become mere tokens for stock market speculation". Jurisdiction to insure the attainment of these ends in the public interest was vested in the Commission, not in the courts.

This exclusive and plenary power of the Commission over capitalization in a reorganization under Section 77 is in no wise lessened by the fact that the Commission's determination of the capital structure is subject to judicial

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[1]72nd Cong., 2nd Sess., Report No. 1897 to accompany H. R. 14359.

[2]76 Cong. Rec. 2927.

scrutiny.[1] If in the determination of the capitalization which the public interest permits to be issued by a corporation reorganized under Section 77, the Commission misinterprets or misapplies the law under which it is acting (for example in such manner as to result in confiscation of property rights), or exceeds the power constitutionally granted it by Congress, or acts without supporting evidence, then its determination may be set aside, or, in the language of Section 77, be "disapproved," just as can its determination of a rate to be charged in the future.[2] However, barring such an exercise of its power as to constitute a violation of subsection (e), the Commission's determination both of total capitalization, and of the details of that capitalization, like its determination of a rate,[3] must be accepted by the

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[1] In *In re Erie*, 37 F. Supp. 237, 244 (N. D. Ohio 1940) the report of the Special Master, confirmed by the District Court, said

> "it is my opinion that the Commission's determination of the value of the properties * * * for reorganization purposes—*i.e.* the total capitalization—is conclusive unless it clearly appears (1) that the Commission applied improper standards of valuation, or (2) that its finding is wholly unsupported by the evidence. * * * This conclusion is not inconsistent with the view that the court is required to exercise an independent judgment in determining that the Plan complies with the requirements of Section 77."

[2] See *Mississippi Valley Barge Line* v. *United States*, 292 U. S. 282, 286 (1934).

[3] *Cf. United States* v. *Morgan*, 313 U. S. 409 (1941), in which the Court said (p. 417):

> "We are in the legislative realm of fixing rates. This is a task of striking a balance and reaching a judgment on factors beset with doubts and difficulties, uncertainty and speculation. On ultimate analysis the real question is whether the Secretary or a court should make an appraisal of elements having delusive certainty. Congress has put the responsibility on the Secretary and the Constitution does not deny the assignment."

Similarly, Congress has put the responsibility of determining capitalization on the Commission.

court as the basis for its judicial determination of the *remaining* questions of private rights involved in the reorganization.[1]

5. The Ultimate Jurisdiction of the Court to Determine the Private Rights of the Various Securityholders.

Conversely, (1) the determination of whether the Commission's conclusions on the questions thus within the Commission's exclusive jurisdiction contain such errors of law, or are so lacking in evidentiary support, as to violate the private rights of any of the existing securityholders, as well as (2) the ultimate determination of the nature and extent of the contractual rights of each class of existing creditors and stockholders and of whether a plan approved by the Commission affords due recognition of those rights, are essentially judicial functions, within the province of the court.

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[1] In *Akron, Canton & Youngstown Ry. Co.* v. *Hagenbuch*, 128 F. (2d) 932, 940 (C. C. A. 6th, 1942), the Court said:

> "Historically, the power to value railroad properties for rate making and capitalization purposes has always been lodged in the Interstate Commerce Commission.
>
> "There is nothing in the present Act [Section 77] which would indicate that the Congress intended to deprive the Commission of any of the powers it had so long exercised in valuing railroad properties for capitalization purposes.
>
> "The determination of the *value* of the properties, and the *amount* and *character* of *capitalization*, are legislative functions affecting the public interest and are *exclusively* within the province of the Commission under the Act. The only qualification is that the court shall independently determine whether, in the exercise of its jurisdiction, the Commission has acted fairly within the bounds of the Constitution and not arbitrarily."

As to many questions essentially within the ultimate jurisdiction of the court, the latter should give great weight to the reasoning and conclusions of the Commission, as an experienced expert. For example, the Commission has particular ability to judge the earning power of the various parts of railroad systems securing different securities and, hence, to determine whether the new securities allocated to the different old securities are such as to insure to each class of creditors the equitable equivalent of the assets of the debtor available for the satisfaction of its claim, as those claims are legally determined by the court.

Respect for the Commission's expert judgments on such questions, even to the point of regarding them as "well nigh conclusive" and "almost as verities,"[1] does not, however, require construction of Section 77 at the extreme opposite pole from that taken by the Circuit Court of Appeals below. Yet revulsion at the unworkability of Section 77 as construed by that Court has led to the argument that Section 77 cannot be made workable unless all the findings and conclusions of the Commission are, except only for errors of law, binding and conclusive upon the court.

In support of this extreme position it is argued (1) that problems affecting the public interest and problems affecting the rights of securityholders are so hopelessly intertwined that their separation is impracticable; (2) that no such distinction of jurisdiction between the two types of problems is made by Section 77 itself; and (3) that unless Congress had intended to divest the courts of, and to vest the Commission with, substantially final jurisdiction, except

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[1] *In re Chicago & North Western Ry.*, 121 F. (2d) 791, 796 (C. C. A. 7th, 1941).

for errors of law, over all questions involved in a reorganization, it would not have enacted Section 77 at all, because Section 20a of the Transportation Act would have sufficed.

These arguments, it is submitted, (1) are factually unsound; (2) disregard the clear, although perhaps not perfect, draftsmanship of Section 77; and (3) are in conflict with the entire legislative history of that Section.

The view that problems of public interest and problems of private rights of securityholders are so hopelessly intertwined as to prevent segregation may in part be due to failure adequately to analyze the problem of formulating a railroad reorganization plan. There are three distinct steps.

From the standpoint of the venture as an entirety a reorganized capitalization must first be found which will represent, both in its aggregate amount and its classification, the probable future earning power of the property at the various levels of changing business cycles. That capitalization must be determined in the light of its being "compatible with the public interest" within the meaning of those words of art which had been established before the enactment of Section 77. To be sure the molding of the capitalization will be affected by the necessities of the two remaining problems, but the controlling factor as to both aggregate amount and classification is the public interest.

Next, the nature and extent of the contractual rights of each existing class of creditors and stockholders must be determined as a basis for determining the nature and extent of the participation by each class. Such a determination will involve not merely questions of law but a multitude of questions of fact, most of which are not even

remotely connected with the public interest. For example, as in the *Western Pacific* case, the relative liens of two mortgages may depend upon disputed factual circumstances in connection with their creation; or upon disputed facts as to whether equipment has been purchased for use upon one property or upon another; or upon disputed facts as to whether the proceeds of bonds under one mortgage have been expended upon property claimed by a specific lien of a later mortgage, as against the after-acquired clause of the earlier mortgage; or upon disputed facts claimed by one security to create an estoppel against the holders of another security, etc. Perhaps the rights of a class will depend upon disputed facts claimed to establish fraud. The Commission had acquired no expertness, indeed it had had no experience, in the determination of such questions prior to the enactment of Section 77. It has acquired little such experience in the administration of that Section. In few cases have disputes between classes of securities as to their respective contractual rights been pressed to a conclusion either before the Commission or before the court prior to Commission action upon a plan. Where they have been so pressed before the Commission, it has itself recognized, as in the *Western Pacific* case, that its determinations are tentative only and that final decision is for the court.[1]

The third step in the reorganization process is the distribution of the capitalization among the several classes of creditors and stockholders in such manner as to give each, in terms of the new securities, its equitable equivalent of the assets of the debtor available for the satisfaction of its claim, as those claims have legally been determined. This

[1] R. 262.

is a problem upon which admittedly the experience of the Commission in determining earning power and security values will be expert and helpful. It is, however, essentially a problem of the relative nature and extent of the private rights of securityholders *inter se* and not a problem comprehended in the words of art, "the public interest." Furthermore, it is not a problem as to which the courts are without experience. The multitude of cases which have arisen under Section 77B and later Chapter X have far exceeded the number of railroad reorganization cases under Section 77. The courts have an experience even on this type of question entirely comparable to that of the Commission.

Had Congress intended to take away from the courts their traditional jurisdiction to determine the purely factual questions embodied in the second category of reorganization problems as above analyzed, indeed, if it had intended such a divestment in respect of the questions involved in the third category, it would have used entirely different language and an entirely different technique of drafting than was used in Section 77.

By subsection (d) the Commission is vested with jurisdiction to *determine* a plan that will be compatible with the public interest. Because the plan must be complete and therefore must allocate new securities with due recognition of the private rights of the securityholders, the Commission is required preliminarily to have an *"opinion"* that its plan will meet the requirements of subsection (e).

As has already been pointed out, the court is not given jurisdiction even to express any "opinion" as to the questions of "public interest". But the grant of jurisdiction to determine the questions of "due recognition of the rights of

each class of creditors and stockholders,"[1] and of "the nature of their respective rights and interests,"[2] is in terms to the court.

Objectors to a plan approved by the Commission are required by subsection (e) to file with the court "detailed and specific objections in writing to the plan and their claims for equitable treatment." Are these words which the expert lawyers who drew Section 77 would have used to limit an objector to raising solely questions of law before the court?

The court is then required to hold a hearing respecting these "claims for equitable treatment," at which the court may receive evidence. It has been the practice of the district courts in most reorganization cases, as was done in the *Western Pacific* case, to receive additional evidence offered by objectors to strengthen their position and in turn evidence offered to rebut the objectors' evidence. After such a hearing, and such receipt of evidence, the court is not merely required to express an "opinion" as to "the due recognition of the rights of each class of creditors and stockholders" raised by such "claims for equitable treatment"; it must be "*satisfied.*" If it is not satisfied and returns the case to the Commission, it certifies to the Commission "a copy of any evidence received." Is this a description of a hearing solely to discover errors of law? If the court is limited to determining whether or not, in a finding respecting a claim, the Commission committed an error of law upon the facts found by it, why should the court take evidence?

By the organization scheme of Section 77, as a matter of draftsmanship, Congress thus took a clear distinction

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[1]Subsection (e). [2]Subsection (c)(7).

between questions affecting the public interest and questions affecting the contractual rights of creditors and stockholders and their due recognition. Even if there were any practical difficulty (which factually there is not) in distinguishing between the two types of questions, the express language and the organization of Section 77 would compel respect for the distinction.

Apart from the traditional jurisdiction of the courts in suits by different creditors involving questions of fact as to their respective rights, Congress had another excellent reason for not vesting in the Commission jurisdiction to determine such questions in a railroad reorganization, free from judicial review except for mistakes of law. Many of the Section 77 reorganizations, as in the *Western Pacific* case, have involved RFC claims. The Commission is an active participant in the creation of RFC loans to railroads and the determination of their security. It would be of doubtful propriety to vest in the Commission jurisdiction finally to determine disputed questions of fact in connection with such loans, perhaps involving even action of the Commission itself. The courts have already found it necessary to set aside two reorganization plans as unduly preferential to RFC, one wholly on factual grounds and the other on grounds involving mixed questions of law and fact.[1] In another case the court found it necessary to set aside a plan approved by the Commission as involving undue preference of certain classes and inadequate treatment of other classes.[2] The court's determination in this third case was upon grounds wholly factual.

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[1] *In re Denver & Rio Grande Western R.R.*, 38 F. Supp. 106 (D. Colo. 1940); *In re St. Louis-San Francisco Ry.* (E. D. Mo., May 25, 1942, not yet reported).

[2] *In re New York, N. H. & H. R. R.* (D. Conn., Dec. 8, 1941, not yet reported).

It is submitted that in all three of these cases the courts exercised a jurisdiction intended to be vested in them by Section 77.

The argument that Section 77 was superfluous unless it vested in the Commission exclusive and final jurisdiction over all questions of fact in railroad reorganizations quite disregards the many reasons, apart from the wish to give the Commission initial control of railroad reorganization plans, for the enactment of Section 77. The first of the several bills out of which that section developed[1] was directed entirely to the elimination of the fictions of the equity receivership and sale, the elimination of the dangers of ancillary receiverships, and the binding of dissenting minorities without provision for cash payment. That original bill contemplated that the Commission would be called upon to act on questions of public interest only after the court had made preliminary decisions on questions of the private rights of the securityholders *inter se*. As has already been pointed out, Section 77 as finally enacted reversed the order of the two types of determinations and contemplated, first, determination of the problems of public interest with a preliminary "opinion" as to the private rights questions, followed, second, by the ultimate determination in the courts of the latter questions. It merely reversed the old order of determination. It no more transferred to the Commission from the courts jurisdiction over the purely judicial types of questions, than did the original bill contemplate transfer to the courts from the Commission of the latter's jurisdiction over the purely legislative types of questions affecting the public interest.

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[1]S., 4921, 72nd Congress, 1st Session (1932).

The job of railroad reorganization is necessarily one in which the Commission and the courts each have an appropriate independent function, each in a field in which jurisdiction follows experience and expertness. It is thus that "the judicial process * * * is, at it were, brigaded with the administrative process of the Commission,"[1] that the authority of the court is "intertwined" with that of the Commission, and that the judicial and administrative functions "work co-operatively in reorganizations."[2] The two bodies are in every respect "to be deemed collaborative instrumentalities of justice and the appropriate independence of each should be recognized by the other."[3]

This broad demarcation of the functions of the Commission and the courts under Section 77 has been recognized not only by the District Court in the instant case but by other district courts in other reorganization cases.[4]

Two Circuit Courts of Appeals, other than the Ninth Circuit in the instant case, have had to deal with the problem, the Sixth Circuit in the *Akron, Canton & Youngstown*

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[1] *Palmer* v. *Massachusetts*, 308 U. S. 79 (1939).

[2] *Warren* v. *Palmer*, 310 U. S. 132 (1940).

[3] *United States* v. *Morgan*, 313 U. S. 409, 422 (1941).

[4] *In re Akron, Canton & Youngstown Ry.* (N. D. Ohio, 1939, not reported); *In re Erie R. R.*, 37 F. Supp. 237, 243-5 (N. D. Ohio 1940); *In re St. Louis-San Francisco Ry.* (E. D. Mo. 1942, not yet reported). In other cases the district courts have said that it was unnecessary for them precisely to determine the respective jurisdictions of the Commission and the Courts in view of the facts that in any event they attached great weight to the Commission's views and, in the particular case, entirely agreed with the conclusions of the Commission on the merits. *In re Chicago & North Western Ry.*, 35 F. Supp. 230, 253 (N. D. Ill. 1940); *In re Chicago, Milwaukee, St. Paul & Pacific R. R.*, 36 F. Supp. 193, 202-3 (N. D. Ill. 1940); *In re Missouri Pacific R. R.*, 39 F. Supp. 436, 442 (E. D. Mo. 1941). The opinion of the District Judge in the instant case indicates that he might have avoided the Circuit Court of Appeals' criticism of his opinion by resting his decision solely upon the same ground (R. 1597).

case and the Seventh Circuit in the *North Western* and *Milwaukee* cases.[1] Both these Courts recognized that the jurisdictions of the Commission and the courts are separate and distinct, and each recognized that the jurisdiction of the courts to review the Commission's determinations of capitalization questions is a limited jurisdiction.[2]

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[1] *Akron, Canton & Youngstown Ry. Co.* v. *Hagenbuch*, 128 F. (2d) 932, 940 (1942); *In re Chicago & North Western Ry.*, 121 F. (2d) 791 (1941); and *In re Chicago, Milwaukee, St. Paul & Pacific R.R.*, 124 F. (2d) 754 (1941).

[2] In *Akron, Canton & Youngstown* case, *supra*, the Sixth Circuit Court said (at p. 940):

> "The duties imposed on the courts and the powers conferred on the Interstate Commerce Commission under this Section of the Act, when construed in relation to other Sections, are separate and distinct. As to some matters under the Act, such as the determination of value, a broad discretion is lodged in the Interstate Commerce Commission and the court does not sit as a board of revision to substitute its judgment for that of the Commission. In such matters, the judicial inquiry into the facts goes no further than to ascertain whether there is substantial evidence to support the findings of the Commission and the question of the weight of the evidence in determining such matters lies with the Commission when acting within its statutory authority."

The Seventh Circuit in a decision on an interim order in the *North Western* case, 121 Fed. (2d) 791, 796 (1941), stated:

> "In the field wherein it exercises the powers expressly given it, the findings of the I. C. C. are well-nigh conclusive. True, it may not be said that the orders of the I. C. C. are unassailable if wholly lacking in evidentiary support. But where, in matters relating to plans of reorganization, earning power of debtor, its operations, having in view the greatest service to the public and the greatest net earnings for its security holders, the findings of the I. C. C. should be, as they are, accepted almost as verities by the courts."

The final decisions of the Seventh Circuit on the *Milwaukee* and *North Western* plans, however, leave that Court's views of the Commission's jurisdiction somewhat uncertain.

6. Conclusion

In the *Western Pacific* proceeding the Commission and the District Court have each recognized the appropriate jurisdiction and independence of the other.

The Commission's determination of the various questions as to the lien of the two mortgages, affecting solely the private rights of the bondholders, was expressly tentative and subject to the final determination of the District Court.[1]

A superficial perusal of the opinion of the District Judge demonstrates that he recognized and carefully performed his duty to decide whether the Commission, in its determination of the questions of public interest, had "acted fairly, within the bounds of the Constitution, and not arbitrarily" and whether, in its tentative determination of the legal rights of the old securities and its allocations of new securities in recognition of those rights, it had fully complied with subsection (e).[2] To the extent of such judicial review he did regard himself, in the language of the Circuit Court of Appeals,[3] "not concluded by any determination made by the Commission." Within the proper demarcation of his jurisdiction as to the questions of "public interest," and to the full within his jurisdiction to determine the private rights of the existing securityholders and whether allocations conformed to those private rights, he did exercise his "independent judgment."

In his 31-page opinion the District Judge declared that he had "read the record", "carefully considered all the objections" and "read the briefs of the respective counsel in support of the objections".[4] He might have added that

[1]R. 262. [2]R. 1596-7. [3]R. 2674.
[4]R. 1597.

he had heard four days of oral argument. As a result he had reached the independent informed judgment that he was "wholly in accord" with all the conclusions reached by the Commission. He therefore held all the objections to the Commission Plan to be without merit and overruled.

The "possible misconception" as to the respective jurisdictions of the Commission and the courts was on the part of the Circuit Court of Appeals, not the District Court. That "misconception" should be corrected by this Court, but this Court should at the same time negative any "misconception" at an opposite pole.

IV

UPON THE ENTIRE RECORD, THIS COURT SHOULD REVERSE THE DECREE OF THE CIRCUIT COURT OF APPEALS AND AFFIRM THE ORDER OF THE DISTRICT COURT APPROVING THE COMMISSION PLAN.

It apparently is not, and it cannot be, disputed that, notwithstanding the failure of the Circuit Court of Appeals to deal with many of the exceptions of the appellants below, this Court has jurisdiction to examine the entire record and, upon consideration of the objections before the District Court and the exceptions before the Circuit Court of Appeals, direct that all of them be overruled and the appropriate order of the District Court approving the Plan be affirmed.[1]

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[1] *Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U. S. 555, 567 (1931); *Cole* v. *Ralph*, 252 U. S. 286, 290 (1920); *Delk* v. *St. Louis & San Francisco R. R.*, 220 U. S. 580, 588 (1911); *Lutcher & Moore Lumber Co.* v. *Knight*, 217 U. S. 257, 267 (1910); *Donovan* v. *Pennsylvania Co.*, 199 U. S. 279, 292 (1905).

The objecting junior interests filed in the District Court an untold number of objections to the Commission Plan,[1] and in the Circuit Court of Appeals a total of 76 exceptions.[2] Nevertheless, it is believed that the substance of all the objections of all the junior interests have already been discussed in this brief, except for three.

1. Both the Debtor and RCC object to January 1, 1939, as the effective date of the Plan. The Debtor argues that the effective date should be approximately August 2, 1935, the date of the filing of the Debtor's Section 77 petition. RCC, asserting that creditors are entitled to their contract rights to the date of the actual consummation of reorganization, argues that the effective date should be substantially the actual date the Plan is put into effect.

The Debtor's contention is foreclosed by the specific holding of this Court in the *Consolidated Rock Products* case that unpaid interest accruing on senior claims during the reorganization proceeding is part of the claim whose absolute priority must be recognized in reorganization.[3]

The reasoning which defeats the Debtor's contention tends to sustain that of RCC. However, the injury in the present case, arising from computing claims for reorganization purposes as of January 1, 1939, when in fact reorganization cannot now be consummated substantially before 1944, falls upon

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[1]R. 892-1017. [2]R. 1627-54.

[3]See also *Ticonic Bank* v. *Sprague*, 303 U. S. 406, 413 (1938).

the First Mortgage Bondholders, not upon the objecting RCC. If the Commission Plan were to be disapproved and a new plan given an effective date of January 1, 1943, four additional years' interest, aggregating nearly $10,000,000, will have accrued upon the First Mortgage Bonds and require provision senior to any provision for the RCC Notes. If January 1, 1944, is the effective date, the amount of such additional interest will be nearly $12,500,000.

2. The junior interests objected below to the fact, amount, and mandatory character of the Capital Fund provided for by the Commission Plan. This Capital Fund is derived through setting aside, out of available net income after fixed charges and before contingent charges, an amount for capital expenditures not exceeding $500,000 annually, or at any time an aggregate unexpended amount of $1,000,000.[1]

That it is in the interest of both the public and all the creditors that necessary additions and betterments be financed out of earnings rather than by selling First Mortgage Bonds at the prohibitive discounts at which they would now have to be sold, must be patent. The evidence before the Commission as to the Debtor's past requirements for capital purposes supports the $500,000 figure.[2] In the light of today's conditions, it is, if anything, inadequate. While the Committee would have preferred that the creation of the Fund be left to the discretion of

[1]R. 381. [2]R. 309, 1870.

the reorganized company's board of directors, the Committee recognizes that as to this feature, as well as to the fact and amount of such a Fund, the matter is one clearly affecting the public interest and within the exclusive determination of the Commission in the absence of arbitrary action. None of the objectors have suggested that the Commission's decision in respect of this Fund has been arbitrary.

3. The RCC and ACJ Notes are secured, in addition to the collateral pledged by the Debtor and dealt with in the Commission Plan, by so-called accommodation collateral pledged by WP Corp. WP Corp. urges that failure of the Commission Plan affirmatively to provide for the surrender of the accommodation collateral to the pledgors constitutes confiscation; while RCC objects that the failure of the Commission Plan affirmatively to provide that the same collateral may be retained by the pledgees is a violation of RCC's rights.[1]

The problem of this accommodation collateral is not one which can properly be dealt with in a plan of reorganization for the Debtor. Whether the pledgees, after realizing upon the collateral pledged by the Debtor and receiving new securities therefor under the Commission Plan, have a deficit as against the accommodation pledgor is a question not affecting the Debtor but one affecting the relationships between the accommodation pledgor and the pledgees.

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[1]R. 271, 345.

Though this Court may agree that none of the objections of the junior interests would seem to have merit, it may have doubt whether the Commission Plan fully meets the tests laid down by this Court for the "fair and equitable" recognition of the "absolute priorities" of the existing First Mortgage Bonds.

The 4½% rate upon the Income Mortgage Bonds, contrasting with the 5% rate upon the present First Mortgage Bonds, may seem unnecessarily to impose a sacrifice upon the present First Mortgage Bondholders. The matter of the new interest rate, however, the Committee believes to be one affected with a "public interest" and within the exclusive determination of the Commission. The effect of the Commission's imposing the lower rate is to increase the amount of the lost rights of the present First Mortgage Bondholders, for which "full compensation" must be made. The conversion right of the new Income Bonds, the participating right of the new Preferred Stock, and the Income Mortgage Sinking Fund, even taken together, may seem somewhat inadequate compensation for the rights of the existing First Mortgage Bondholders required to be surrendered by the Commission Plan. The differential between $57 and $62 per share, the price at which the new Common Stock is allotted to the senior First Mortgage Bonds and the price at which it is allotted to the RCC Notes, may seem of questionable adequacy to satisfy the "quantitative" test of priority recognition.

But the present First Mortgage Bondholders have now received no interest since September 1, 1933, notwithstanding the recently increasing earnings and rapidly accumulating cash in the reorganization trustees' hands. Were the Commission Plan to be set aside and new allocations made in an attempt fully to compensate for the lost rights of the

existing First Mortgage Bondholders, all the additional value that those Bondholders could receive, within the capitalization representing the "reorganization value" found by the Commission, would be a small amount of Common Stock. The First Mortgage Bondholders, together with the RFC, receive, under the Commission Plan, 77% of the total Common Stock. Commissioner Miller, in urging an increase of the Common Stock in order to allot the junior interests a larger percentage, correctly characterized it as of "little or no market value."

The few shares of additional Common Stock which might thus be added to the allocations to the First Mortgage Bondholders by a theoretically better plan than the Commission Plan are of insignificant value to the existing First Mortgage Bondholders as compared with the importance of getting this property reorganized, securing the cash return upon the existing First Mortgage investment which the earnings reasonably permit, and, not without importance, securing some effective voice in the operating and financial problems of the property.

The Committee therefore urges this Court to take a practical view of the situation and not to push the widely current belief that securityholders are incompetent to take care of themselves[1] to the point of requiring for the First Mortgage Bondholders a degree of compensation for surrendered rights whose attainment would impose upon the

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[1]The first expression of this thought that we have found is that in *In re English, Scottish and Australian Chartered Bank*, 3 Ch. 385, 396 (1893). It has been more picturesquely put by Frank in *Some Realistic Reflections on Some Aspects of Corporate Reorganization* (1933) 19 Va. L. Rev. 541, 569: "Courts of equity have a tradition of aiding the helpless, such as infants, idiots and drunkards. The average security holder in a corporate reorganization is of like kind."

First Mortgage Bondholders far greater injury than any possible value of such compensation.

This reorganization proceeding has now dragged along through the Commission and the Courts for more than seven years over every obstacle which the junior interests could manage to interpose. The multiplicity of corporate entities through which the principal junior interests have acted has created an appearance of confusion of issues and procedural problems, materially adding to the delay. The Committee urges that the public interest in the final disposition of the Western Pacific reorganization and the many questions which it, in common with most other railroad reorganizations, involves, as well as the interests of the First Mortgage Bondholders themselves, require that this Court so act upon the present Commission Plan as to give substance to its earlier assurance that "there is no occasion" for the courts, the Commission or the senior securityholders "to yield to such pressures."[1]

The Committee believes that upon consideration of the entire record this Court can reach no other conclusion than that the decision of the Circuit Court of Appeals for the Ninth Circuit should be reversed, and the Order of the District Court dated August 15, 1940, affirmed. If, however, this Court shall (as the Committee does not believe will be the case) find any error in the action of the Commission or the District Court, the Committee urges that this Court, in addition to correcting such error, also affirm such of the determinations of the District Court as may be found to be without error. Only by such action can repetition of possible errors already made be avoided without

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[1] *Case* v. *Los Angeles Lumber Products Co., Ltd., supra*, at p. 129.

ultimate correction in this Court at some indefinite future time, and only thus may the reorganization of the Debtor be consummated with some degree of expedition.

V

SECURITYHOLDERS WHO DEFEND IN THE CIRCUIT COURTS OF APPEALS PLANS PROMULGATED AND APPROVED BY THE COMMISSION, AND ALSO APPROVED BY THE DISTRICT COURTS, SHOULD NOT BE ASSESSED THE COSTS OF THE APPEALS IF THE APPEALS ARE SUCCESSFUL. SUCH COSTS SHOULD BE ASSESSED DIRECTLY AGAINST THE DEBTOR'S ESTATE.

Such costs are not nominal. In the instant case they aggregate $4,239.29, and in the more complicated cases already pending in various circuit courts of appeals they will greatly exceed that amount.

Section 77 contemplates that the Commission may, as it did in the instant case, formulate its own plan of reorganization independently of any proposals of any of the parties, whereas under Chapter X of the Bankruptcy Act the Securities and Exchange Commission acts only in an advisory capacity in the formulation of reorganization plans.[1] Notwithstanding this fact, Section 77, unlike Chapter X,[2] provides no specific machinery whereby the Commission may appear in the proceeding in the district court with reference to the plan. In practice the Commission has not sought to defend its plans before the courts. Those railroad securityholders who assume the responsibility and expense of defending Commission proposals in the district courts are therefore supplying to the district courts assist-

[1] § 172, 11 U. S. C. § 572.
[2] § 208, 11 U. S. C. § 608.

ance which they might not otherwise have in performing their functions under Section 77.

To penalize such securityholders for continuing to defend the Commission's plans in the circuit courts of appeals, after the district courts have approved such plans, is not only wholly unfair and inequitable but necessarily will discourage securityholders and mortgage trustees from performing a useful, if not necessary, function in assisting the circuit courts of appeals to arrive at proper decisions.[1]

Irrespective of the balance of the case, this Court should reverse that part of the Decree below imposing costs of the appeal from the District Court upon the creditors who defended the Commission Plan before the District Court and the Circuit Court of Appeals.

VI

CONCLUSION

The Decree of the Circuit Court of Appeals for the Ninth Circuit, entered November 28, 1941, as modified by the Orders of February 12 and February 16, 1942, should be reversed, and the Order of the District Court, entered August 15, 1940, should be affirmed.

Dated September 14, 1942.

Respectfully submitted,

ROBERT T. SWAINE,
Attorney for Frederick H. Ecker, John W. Stedman and Reeve Schley, constituting the Institutional Bondholders Committee, Petitioners.

HERBERT W. CLARK,
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[1]See *In re Chicago & North Western Ry.*, 121 F. (2d) 791, 798 (C. C. A. 7th, 1941).

APPENDIX A

Bankruptcy Act, § 77 (11 U. S. C. § 205).

* * * * * * * *

"(c) * * *

"(7) The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests. Such division shall not provide for separate classification unless there be substantial differences in priorities, claims, or interests.

* * * * * * * *

"(d) The debtor, after a petition is filed as provided in subsection (a) of this section, shall file a plan of reorganization within six months of the entry of the order by the judge approving the petition as properly filed, or if heretofore approved, then within six months of August 27, 1935, and not thereafter unless such time is extended by the judge from time to time for cause shown, no single extension at any one time to be for more than six months. Such plan shall also be filed with the Commission at the same time. Such plans may likewise be filed at any time before, or with the consent of the Commission during, the hearings hereinafter provided for, by the trustee or trustees, or by or on behalf of the creditors being not less than 10 per centum in amount of any class of creditors, or by or on behalf of any class of stockholders being not less than 10 per centum in amount of any such class, or with the consent of the Commission by any party in interest. After the filing of such a plan, the Commission, unless such plan shall be considered by it to be prima facie impracticable, shall,

after due notice to all stockholders and creditors given in such manner as it shall determine, hold public hearings, at which opportunity shall be given to any interested party to be heard, and following which the Commission shall render a report and order in which it shall approve a plan, which may be different from any which has been proposed, that will in its opinion meet with the requirements of subsections (b) and (e) of this section, and will be compatible with the public interest; or it shall render a report and order in which it shall refuse to approve any plan. In such report the Commission shall state fully the reasons for its conclusions.

"The Commission may thereafter, upon petition for good cause shown filed within sixty days of the date of its order, and upon further hearings if the Commission shall deem necessary, in a supplemental report and order modify any plan which it has approved, stating the reasons for such modification. The Commission, if it approves a plan, shall thereupon certify the plan to the court together with a transcript of the proceedings before it and a copy of the report and order approving the plan. No plan shall be approved or confirmed by the judge in any proceeding under this section unless the plan shall first have been approved by the Commission and certified to the court.

"(e) Upon the certification of a plan by the Commission to the court, the court shall give due notice to all parties in interest of the time within which such parties may file with the court their objections to such plan, and such parties shall file, within such time as may be fixed in said notice, detailed and specific objections in writing to the plan and their claims for equitable treatment. The judge shall, after notice in such manner as he may determine to the debtor, its trustee or trustees, stockholders, creditors, and the Commission, hear all parties in interest in support of, and in opposition to, such objections to the plan and such claims for equitable treatment. After such hearing,

and without any hearing if no objections are filed, the judge shall approve the plan if satisfied that: (1) It complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; (2) the approximate amounts to be paid by the debtor, or by any corporation or corporations acquiring the debtor's assets, for expenses and fees incident to the reorganization, have been fully disclosed so far as they can be ascertained at the date of such hearing, are reasonable, are within such maximum limits as are fixed by the Commission, and are within such maximum limits to be subject to the approval of the judge; (3) the plan provides for the payment of all costs of administration and all other allowances made or to be made by the judge, except that allowances provided for in subsection (c), paragraph (12) of this section, may be paid in securities provided for in the plan if those entitled thereto will accept such payment, and the judge is hereby given power to approve the same.

"If the judge shall not approve the plan, he shall file an opinion, stating his conclusions and the reason therefor, and he shall enter an order in which he may either dismiss the proceedings, or in his discretion and on motion of any party in interest refer the proceedings back to the Commission for further action, in which event he shall transmit to the Commission a copy of any evidence received. If the proceedings are referred back to the Commission, it shall proceed to a reconsideration of the proceedings under the provisions of subsection (d) of this section. If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission. The plan shall then be sub-

mitted by the Commission to the creditors of each class whose claims have been filed and allowed in accordance with the requirements of subsection (c) of this section, and to the stockholders of each class, and/or to the committees or other representatives thereof, for acceptance or rejection, within such time as the Commission shall specify, together with the report or reports of the Commission thereon or such a summarization thereof as the Commission may approve, and the opinion and order of the judge: *Provided*, That submission to any class of stockholders shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, (a) that at the time of the finding the corporation is insolvent, or that at the time of the finding the equity of such class of stockholders has no value, or that the plan provides for the payment in cash to such class of stockholders of an amount not less than the value of their equity, if any, or (b) that the interests of such class of stockholders will not be adversely and materially affected by the plan, or (c) that the debtor has pursuant to authorized corporate action accepted the plan and its stockholders are bound by such acceptance: *Provided further*, That submission to any class of creditors shall not be necessary if the Commission shall have found, and the judge shall have affirmed the finding, that the interests of such class of creditors will not be adversely and materially affected by the plan, or that at the time of the finding the interests of such class of creditors have no value, or that the plan provides for the payment in cash to such class of creditors of an amount not less than the value of their interests. For the purpose of this section the acceptance or rejection by any creditor or stockholder shall be in writing, executed by him or by his duly authorized attorney, committee, or representative. If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests

or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission.

Upon receipt of such certification, the judge shall confirm the plan if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required under this subsection holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required under this subsection holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided*, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e): *Provided further*, That if, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States

or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof:. *Provided further,* That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed. If the judge shall confirm the plan, he shall enter an order and file an opinion with a statement of his conclusions and his reasons therefor. If the judge shall not confirm the plan, he shall file an opinion, with a statement of his conclusions and his reasons therefor, and enter an order in which he shall either dismiss the proceedings, or, in his discretion and on the motion of any party in interest, refer the case back to the Commission for further proceedings, including the consideration of modifications of the plan or the proposal of new plans. In the event of such a reference back to the Commission, the proceedings with respect to any modified or new plan shall be governed by the provisions of this section in like manner as in an original proceeding hereunder.

"If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and original cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts."

APPENDIX B

FEDERAL INCOME TAX LIABILITY FOR 1940 AND 1941

1. Computed on the basis of the existing capitalization of the Debtor

1940

There would be no Federal income tax liability for the year 1940.

1941

Although the net income for the year 1941 was $750,177, there would be no Federal income tax liability for that year if the Debtor's claim of a deduction for a net operating loss carryover of $2,799,265 from the two preceding years is allowed.

If such deduction for a net operating loss carryover is not allowed, the Federal income tax liability for 1941 would be $232,304, computed as follows:

Earnings Available for Fixed Charges	$4,551,738[1]	
Less: Fixed Charges	3,801,561[1]	
Normal Tax Net Income	$ 750,177	
Normal Tax (24%)		$180,042
Surtax		
6% on first $25,000	1,500	
7% on remainder ($725,177)	50,762	52,262
Total Normal Tax and Surtax		$232,304

[1]To reported ~~1940~~ 1941 earnings (see p. 7, *supra*) has been added rent for leased facilities of $3,600, which amount is included in Fixed Charges as shown above.

2. Computed on the basis of the capitalization of the reorganized company

In the following computations, the funded debt of the Reorganized Company is taken at $33,969,125, the amount of debt for which the Commission Plan provides.

1940

On the basis of the above assumption, the total Federal income tax liability of the Reorganized Company for the year 1940 would be ~~$289,041~~ 288,177, computed as follows:

Earnings Available for Interest	$2,649,797	
Less: Interest Charges	1,449,060	
Normal Tax Net Income	$1,200,737	
Normal Tax (24%)		$288,177

1941

On the basis of the above assumption, the total Federal income tax liability of the Reorganized Company for the year 1941 would be $960,464, made up of the following items:

Normal Income Tax	$743,779	
Surtax	216,685	
		$960,464

These figures are computed as follows:

Earnings Available for Interest		$4,548,138
Less: Interest Charges		1,449,060
Normal Tax Net Income		$3,099,078
Normal Tax (24%)		$ 743,779
Surtax		
6% on first $25,000	$ 1,500	
7% on remainder ($3,074,078)	215,185	
		$ 216,685